Deposit Guarantee Schemes in Europe:
Is the Banking Union in need of a third pillar?

Veerle Colaert*

Four years after the original proposal was put on the table, a fully revised Deposit Guarantee Directive[1] has been adopted on 16 April 2014.

This article first offers an analysis of the Directive's contribution to stability of the financial system. Three elements of the Directive are key in this respect: coverage level, payout period and funding of European deposit guarantee schemes.

The Directive is then put in the broader perspective of the Banking Union. As one of its three pillars the Banking Union sets forth a common deposit guarantee system, surpassing considerably the Directive's scope and ambition. This article examines the extent to which a pan-European alternative would indeed provide a more solid contribution to financial stability than Member States' schemes harmonised by the Deposit Guarantee Directive.

The analysis draws from legal history, legal analysis and (law and) economics.

Keywords: deposit guarantee, Banking Union

I. Introduction

a. Background: Banking Union and Deposit Guarantee Directive

1. The Banking Union. When making the case for a Banking Union European leading figures have not shunned the big words. "Crucial for financial stability"; an "imperative to break the vicious circle between banks and sovereigns"[2]; "a key factor in the completion of monetary union" and "a turning point in the current crisis"[3] are just some of the expressions used.

Remarkably, European legislators have managed to agree in an extremely short timeframe of less than three years to create a single authority for prudential banking supervision in the Eurozone, the ECB.[4] In addition a European resolution mechanism for the Eurozone has been

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* The author is financial law professor and co-director of the Jan Ronse Institute for Company and Financial Law at KU Leuven University.

[1] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on DGSs (recast) [2014] OJ L173/149.

[2] European Council, 'Conclusions of the European Council of 27-28 June 2013' EUCO 104/2/13, at 2 and 10.

[3] Benoît Cœuré, Speech at the conference 'Bank funding – markets, instruments and implications for corporate lending and the real economy' (8 October 2012) <http://www.ecb.europa.eu/press/key/date/2012/html/sp121008_1.en.html>.

[4] Council Regulation (EU) N° 1024/2013 of 15 October 2013 conferring specific tasks related to financial stability and banking supervision to the ECB [2013] OJ L287/13.

formally adopted.[5] For there to be a genuine Banking Union, so it has been argued, a shared deposit guarantee system would need to be installed as a third "pillar".[6] The path towards realisation of this third pillar however seems somewhat more tortuous.

2. Goal of deposit guarantee systems. Deposit guarantee systems are commonly said to serve two goals:[7] protecting savers against losing their deposits in case of insolvency of their credit institution, and even more importantly,[8] maintaining the stability of the financial system while avoiding systemic risk.

Indeed, rumours that a credit institution is in financial trouble, easily become a self-fulfilling prophecy when these rumours trigger a bank run. A run leads to liquidity problems as a consequence of which the financial situation of the bank may deteriorate so severely that it can rapidly fall into bankruptcy. Due to direct and indirect spill-over effects[9], this could, in an extreme case, affect the whole financial market and lead to a systemic financial crisis.[10]

If circumstances occur which point at imminent insolvency of a credit institution, a deposit guarantee system will step in to fulfill the institution's obligations towards its depositors up to a certain amount, currently set at EUR 100,000 in the EU.[11] The ratio of the deposit guarantee system is that depositors, knowing that payout of their deposits is substantially guaranteed, will be less inclined to immediately withdraw their deposits from the bank in case of financial turmoil. A deposit guarantee scheme ("DGS") is therefore widely considered a major

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[5] Regulation (EU) N° 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 [2014] OJ L225/1.

[6] President of the European Council Herman Van Rompuy, 'Towards a Genuine Economic and Monetary Union' (26 June 2012) EUCO 120/12, at 4; European Commission, 'A Roadmap towards a Banking Union' (12 September 2012) COM 2012(510), at 6; Benoît Cœuré (n 3).

[7] Basel Committee on Banking Supervision – International Association of Deposit Insurers, 'Core Principles for Effective Deposit Insurance Systems' (2009) (hereinafter referred to as "the IADI 2009 Principles"), principle 1; A Campbell and P Cartwright, 'Deposit Insurance: Consumer Protection, Bank Safety and Moral Hazard' (1999) EBLR at 96.

[8] B Bernet and S Walter, 'Design, Structure and implementation of a modern deposit insurance scheme' (SUERF, The European Money and Finance Forum, Vienna 2009) at 8; European Commission, 'Impact Assessment – Accompanying document to the Proposal for a Directive .../.../EU of the European Parliament and of the Council on DGSs [recast]' (12 July 2010) SEC(2010) 834 final (hereinafter referred to as "Impact Assessment") at 27, where the goals of the directive are described as: "maintaining financial stability by strengthening depositor confidence and protecting their wealth".

[9] *Direct* spill-over effects result from the high interconnectedness in the financial sector: a bankrupt credit institution will not be able to pay back its liabilities to other financial institutions, which may therefore get into trouble themselves. *Indirectly* the bankruptcy of one credit institution may severely harm confidence of the public in the banking sector as a whole. See E. George, Governor of the Bank of England, 'Vital Topic Lecture Speech' at the Manchester Business School (24 February 1998 http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/1998/speech15.pdf) at 8; J. Taylor, "Defining systemic risk operationally" in K. Scott et al (eds), *Ending Government Bailouts As We Know Them* (Hoover Institution Press Publication 2009) at 33.

[10] Bernet and Walter (n 8) at 8. Kaufman and Scot however argue that liquidity problems and depositor runs rarely drove economically solvent independent banks into insolvency, nor do they find empirical evidence that bank failures ever ignited downturns in the macro-economy. See Kaufman and Scot, 'What is systemic risk, and do bank regulators retard or contribute to it' (2003) The Independent Review at 379 and 380. Their contribution however dates back from before the 2007-2010 financial crisis.

[11] Article 6 of Directive 2014/49/EU.

contributing factor to banking stability,[12] despite drawbacks relating to moral hazard problems.[13]

3. New Deposit Guarantee Directive. The policy goal of banking stability will however only be achieved to the extent the system succeeds in inspiring confidence with depositors. The 2008-2009 crisis mercilessly exposed the failure of certain Member States' DGSs to fulfill that role. Therefore a fully revised Deposit Guarantee Directive 2014/49/EU[14] has been adopted on 16 April 2014 (hereinafter referred to as "the Directive").

Apart from certain options left for the Member States and the provisions regarding funding, which only aim at minimum harmonization,[15] the Directive maximally harmonises key rules governing DGSs in the European Union.[16]

However, it remains a far cry from an actual third pillar for the Banking Union in the form of a unified "pan-European" DGS, which may or may not be developed in a distant future.[17]

b. Research questions and structure of this contribution

4. Research question. The central question examined in this contribution is whether, from the perspective of banking stability, the European Union would benefit from a fully-fledged third pillar for its Banking Union rather than mere harmonisation of the standards which national DGSs have to comply with.

Three elements are quintessential for a deposit guarantee system to inspire confidence with depositors and thus to ensure banking stability. First, the coverage granted should be sufficiently high. Second, the payout period should be short, so that depositors do not risk having to wait for payout for a substantial period of time. And third, the scheme should be adequately funded in order to have the means to ensure swift payout. Other elements, such as membership of all credit institutions and public awareness of the existence of the system are equally important,[18] but do not raise many issues in the current European context, where

[12] See footnotes 7 and 8.
[13] About this problem, see more extensively nrs 16 and following.
[14] Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on DGSs (recast), [2014] OJ L173/149.
[15] See nr 52.
[16] Recital 6.
[17] See article 19 (5) of the Directive: "*By 3 July 2019, the Commission shall submit a report, and, if appropriate, a legislative proposal to the European Parliament and the Council setting out how DGSs operating in the Union may cooperate through a European scheme to prevent risks arising from cross-border activities and protect deposits from such risks*".
[18] See Basel Committee on Banking Supervision, 'Basel III: International framework for liquidity risk measurement, standards and monitoring' (December 2010, updated January 2013) at 13, nr 58: "*An "effective deposit insurance scheme" refers to a scheme (i) that guarantees that it has the ability to make prompt payouts, (ii) for which the coverage is clearly defined and (iii) of which public awareness is high*." Compare to S. Schich, 'Financial Turbulance: Some Lessons Regarding Deposit Insurance' (2008) OECD Financial Market Trends, at 70, 72 and 75-76. Schich singles out the following key design challenges: (i) level of coverage (including the speed of reimbursement of depositors); (ii) funding and premium setting; (iii) membership; (iv) safety net interrelations and (v) bank failure resolution mechanisms. See also Impact Assessment (n 8) at 24: "*This long payout delay together with the lack of financial capacity of some schemes would be insufficient to deter depositors from running to their banks … Moreover, the perspective of depositors who owe money to their bank to be reimbursed less or not at all (set-off) in case of a bank failure will not calm down the depositors concerned. Consequently, the Directive would not meet its objectives in terms of protecting depositor wealth, preventing bank runs and contributing to financial stability.*"

membership of credit institutions is indeed obligatory and public awareness is, especially since the crisis, high.[19] Those elements will therefore not be considered in this contribution.

5. Method and structure. This contribution first analyses and evaluates the new Directive in terms of its main goal, banking stability, in order to subsequently examine whether and how a pan-European alternative could further improve achievement of this goal.

A first section will sketch the legal history of the Directive (section I). Then the provisions of the Directive relating to the three elements mentioned – coverage level, payout period and funding – will be analysed and evaluated in view of economic and law and economics literature (sections II-IV). A final section will put the provisions of the new Directive in the broader perspective of the Banking Union and examine whether integration of Member States' DGSs into a pan-European scheme would further enhance banking stability (Section V).

II. Historic background of the Directive

6. Recommendation 87/63/EEC. Rules regarding deposit guarantee have been in force in the European Union (then still the European Economic Community) for over a quarter of a century.

A first step[20] was Recommendation 87/63/EEC.[21] At the time, only six of the then 12 Member States had some kind of DGS. The Recommendation's main aim was that all Member States would have a DGS, meeting certain basic conditions, by 1 January 1990. The provisions of the Recommendation were rather high level; more detailed issues such as coverage level, repayment period or level of funding were not tackled.[22]

The Recommendation did not produce the desired result, as "*[d]espite this Recommendation, some Member States [were] not yet convinced of the need for all their credit institutions to be required to belong to a deposit guarantee scheme, and two Member States [had] not yet introduced one at all.*"[23]

[19] The new Directive requires credit institutions to make available to actual and intending depositors the information necessary for the identification of the DGSs of which the institution and its branches are members within the Union, before entering into a contract on deposit-taking. In practice, if a credit institution faces financial difficulties, the media usually contextualize referring to the DGS.
See on the lack of consumer awareness in the UK during the crisis: N. Kleftouri, 'Rethinking UK and EU Bank Deposit Insurance' (2013) EBLR at 104 and 107

[20] Previous attempts to European legislation in this field failed. See for details: P. Carlotti, 'La directive relative aux systèmes de garantie des depots' in Association Européenne pour le Droit Bancaire et Financier (ed), *Mélanges Jean Pardon* (Bruylant 1996) 112.

[21] Commission Recommendation 87/63/EEC of 22 December 1986 concerning the introduction of deposit-guarantee schemes in the Community [1987] OJ L033/16.

[22] See art. 1:
(a) guarantee compensation for depositors who do not possess the means of properly assessing the financial policies of the institutions to which they entrust their deposits;
(b) cover the depositors of all authorized credit institutions, including the depositors of branches of credit institutions that have their head offices in other Member States;
(c) distinguish sufficiently clearly between intervention prior to winding-up and compensation after winding-up;
(d) clearly set out the criteria for compensation and the formalities to be completed in order to receive compensation.

[23] European Commission, Proposal for a Council Directive on Deposit-Guarantee Schemes, Explanatory Memorandum, COM(92)188 at 3.

7. Directive 94/19/EC. Therefore the Commission came up with a proposal for a Directive in 1992[24] and, after the Economic and Social Committee and the European Parliament had suggested certain amendments, a revised proposal in 1993 (hereinafter "the 1993 Proposal").[25] The latter proposal was finally adopted as Directive 94/19/EC on deposit guarantees on 30 May 1994.[26]

Directive 94/19/EC introduced a minimum coverage level of ECU 20,000 (art. 7 (1)[27]) and a maximum payout period of 3 months (art. 10). The method of financing (funding) of the schemes was not harmonised. As the directive only aimed at minimum harmonization,[28] Member States could still maintain or provide for stricter rules (higher coverage level, shorter payout period).[29]

8. Financial crisis – Directive 2009/14/EC. The first real challenge for European DGSs since the introduction of Directive 94/19/EC was the financial crisis.

In 2007 the banking stability goal of European DGSs was heavily put to the test. Many credit institutions got into severe difficulties and bank runs evidenced the failure of DGSs to achieve their goal.[30] In order to maintain or increase depositor confidence in the system, a number of Member States decided to increase the coverage level of their DGSs.[31] Veritable regulatory competition ensued, with other Member States being forced to follow suit and also increase the coverage level of their DGS as depositors moved their deposits to Member States with DGSs applying higher coverage levels.[32]

Directive 94/19/EC, which had been under review for a while,[33] was amended with urgency to deal with this particular problem[34], increasing the minimum coverage level to EUR 50,000 by 30 June 2009 and setting a maximally harmonised coverage level at EUR 100,000 by 31 December 2010 (with limited exceptions).[35] By the same token the payout period was

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[24] European Commission, Proposal for a Council Directive on Deposit-Guarantee Schemes, Explanatory Memorandum, COM(92)188 (hereinafter "the 92 Proposal").

[25] European Commission, Amended Proposal for a Council Directive on Deposit-Guarantee Schemes, COM(93)253.

[26] Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes [1994] OJ L135 (hereinafter "Directive 94/19/EC").

[27] Until 31 December 1999 Member States where deposits were not covered up to ECU 20 000 could retain the maximum amount laid down in their guarantee schemes, provided that this amount would not be less than ECU 15 000.

[28] Recital 8 of Directive 94/19/EC.

[29] Before the 2008 crisis measures were taken, Denmark, Finland, France, Hungary, Italy, the Netherlands, Poland, Portugal, Sweden and the UK granted higher coverage levels to depositors. Germany had (and still has) a mixed system. On top of adherence to an official, obligatory deposit guarantee system, most credit institutions are also covered by voluntary arrangements to provide additional coverage. See Schich (n 18) at 66-67.

[30] Most notoriously the run on Northern Rock in the UK in September 2007.

[31] The most notable example being Ireland, which provided for a full deposit guarantee as of 30 September 2008. See for a detailed list of other EU Member States with episodes of unlimited deposit insurance coverage regimes during the crisis: Impact Assessment (n 8) annex I, at 100-103.

For a Cross-country comparison of deposit insurance measures taken during the financial crisis, see also FSB, 'Thematic Review on Deposit Insurance Systems. Peer Review Report' (8 February 2012) at 11 and 34-35. These data however do not differentiate between measures taken before and after Directive 2009/14/EC entered into force.

[32] FSB (n 31) 11; Impact Assessment (n 8) 9.

[33] See European Commission, Communication concerning the review of Directive 94/19/EC on Deposit Guarantee Schemes, COM (2006)729.

[34] *Ibid*. at 10; European Commission, Proposal for a directive of the European Parliament and of the Council on DGSs [recast] (12 July 2010) COM (2010) 368, explanatory memorandum, at 2.

[35] Art. 7 of Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay [2009] OJ L68/3.

reduced to 20 working days as from 31 December 2010, with the intention to reduce the payout period further to 10 working days[36].

9. Directive 2014/49/EU. A proposal for a fully redrafted deposit guarantee directive was submitted by the Commission on 12 July 2010.[37] The Commission proposed to keep the maximally harmonised coverage level at EUR 100,000. The payout period on the contrary would be further reduced to one week; and for the first time funding requirements were put up for harmonisation. The proposal was heavily critiqued by a number of Member States and interest groups precisely because of the harmonised funding requirements and short payout period.[38] On account of this headwind, it took almost four years for the Directive to be finally adopted on 16 April 2014.

The new Directive is to be implemented by the Member States in phases. Most provisions need to be transposed by 3 July 2015. With respect to the payout procedure transitional arrangements are foreseen until 1 January 2023 (see nr 33).

In the following sections the provisions on coverage (section III), payout period (section IV) and funding (section V) of Directive 2014/49/EU are analysed from a (law and) economics perspective.

III. Coverage level

a. Rule

10.Coverage level set at EUR 100,000. The coverage level remains at EUR 100,000 for the aggregate deposits of each depositor (art. 6 (1)). Recital 19 reiterates that a harmonised level of deposit protection is necessary to avoid competitive distortions.

New is that the Directive introduces a competence for the Commission to adjust this amount at least every five years in accordance with inflation in the Union.[39] On top of that the Commission should review this amount periodically – at least once every five years – and, if appropriate, submit a proposal to adjust the coverage level (art. 6 (6)).

11.Protection per depositor. The coverage limit applies to the aggregate deposits of each identifiable depositor with the same credit institution, irrespective of the number of deposits he has the currency and the location within the Community of those deposits and irrespective of whether he is mentioned as a holder[40] or whether he is the sole holder of an account (art. 7 (1) and recital 22).

12.Excluded depositors. Not all depositors are covered by the DGS. Whereas Directive 94/19/EC gave the option to Member States to exclude certain depositors from protection, so that exclusions differed throughout the Union, Directive 2014/49/EU harmonises the exclusions. Public authorities and financial institutions are excluded from protection by the deposit

[36] Art. 10.
[37] European Commission, Proposal for a directive of the European Parliament and of the Council on DGSs [recast] (12 July 2010) COM (2010) 368 (hereinafter "the 2010 Proposal").
[38] Next to certain other points of critique. For an overview, see Kleftouri (n 19) at 121-123.
[39] The Commission should do so by adopting delegated acts. Inflation should be measured on the basis of changes in the harmonised index of consumer prices published by the Commission since the previous adjustment (art. 6 (7) and recital 52).
[40] E.g. the inheritors of a deceased depositor.

guarantee fund. Only deposits of local authorities with an annual budget of up to EUR 500 000, can – as an option for Member States – still be excluded (recital 31 – art. 5).[41] Non-financial undertakings are covered irrespective of their size.[42]

Deposits that are not excluded from protection are referred to as "eligible deposits" (art. 2 (4)). Not all eligible deposits are however fully covered. The part of the eligible deposits that does not exceed the coverage level are the "covered deposits" (art. 2 (5)).

b. Exceptions

13.Transition period. By way of transitional provision, Member States which on 1 January 2008 provided for a coverage level of between EUR 100,000 and EUR 300, 000 can continue to apply that higher coverage level until 31 December 2018.[43] This exception should avoid that Member States would have to lower their coverage level and thereby risk to undermine depositor confidence (recital 23).

Only Italy and EEA country Norway are in that situation.[44] On 1 January 2008 no Member State provided for a coverage level of more than EUR 300,000.

A few Member States had introduced unlimited coverage during the crisis. Today this unlimited coverage only still applies in Slovakia, which introduced it however only as of 24 October 2008.[45] The Directive does not provide any transitional measure for this situation.[46]

It should be noted that DGSs which maintain a coverage level in excess of EUR 100,000, are obliged to adjust the target level of funding and the contributions of credit institutions (see nrs 52 and 76) accordingly. As the target level of funding is expressed as a percentage of the covered deposits (see nr 52) no adjustment is actually needed. The contributions of credit institutions will nevertheless need to be higher in order to attain this percentage.

14.Temporary high balances. More important are the second set of exceptions to the EUR 100,000 coverage limit, dealing with situations in which, due to particular and exceptional circumstances, much higher amounts than usual are deposited with the bank.

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[41] Originally the idea was to exclude local authorities from coverage, as there are means under national law to ensure that they can continue to carry out their basic duties to the public and, if needed, have much easier access to credit than ordinary citizens. European Commission, 'Report to the European Parliament and tot the Council – Review of Directive 94/19/EC on DGSs' (12 July 2010) COM(2010)369 final at 4.

[42] SMEs permitted to draw up abridged balance sheets were already covered under Directive 94/19/EC. This subcategory of SMEs amounts to 98,7% of European enterprises (99,8% if all SMEs were covered). Therefore Directive 2014/39/EU has opted to cover all enterprises regardless of size, as the costs of identifying about 1% of depositors during payout, potentially delaying the process of reimbursing depositors, was estimated to be higher than the expected benefits from excluding such a low number of depositors. See European Commission, 'Report to the European Parliament and tot the Council – Review of Directive 94/19/EC on DGSs' (12 July 2010) COM(2010)369 final at 3.

[43] Article 19 (4) and recital 23.

[44] With a coverage level of EUR 103 291 and EUR 224 409 respectively. See Impact Assessment (n 8), Annex I, at 100-102.

[45] See Impact Assessment (n 8) Annex I, at 100-102.

[46] This seems to comply only partly with Principle 10 of the 2009 Core Principles for Effective DGSs, requiring that "*when a country decides to transition from a blanket guarantee to a limited coverage deposit insurance system, or to change a given blanket guarantee, the transition should be as rapid as a country's circumstances permit. Blanket guarantees can have a number of adverse effects if retained too long, notably moral hazard*". Principle 10 however goes on that "*Policymakers should pay particular attention to public attitudes and expectations during the transition period*". See the IADI 2009 Principles (n 7) principle 10.

Protection above EUR 100,000 should be granted for at least three months and no longer than 12 months after such an amount has been deposited or from the moment when such deposit becomes legally transferable, with respect to deposits resulting from certain real estate transactions, linked to particular life events such as marriage, divorce or retirement or based on the payments of insurance benefits or compensation for criminal injuries or wrongful conviction.[47]

It is up to the Member States to decide on the exact conditions of these exceptions (art. 6 (2)) as well as on the temporary maximum coverage level for such deposits, taking into account the significance of the protection for depositors and the living conditions in the Member States (recital 26). This exception thus leaves a significant area of deposit guarantee unharmonised, where Member States can still goldplate their deposit guarantee system.

c. Evaluation in view of economic / law and economics arguments

15.Determinants of an adequate coverage level. The question what an adequate coverage level for a DGS would be, has been much debated. Although the moral hazard argument has been key in this discussion (i), other arguments have been put forward more recently, such as the need for depositor confidence (ii), cost considerations (iii) and the fear for regulatory competition (iv). The choices made in the Directive with respect to coverage will be assessed on the basis of these determinants, to conclude with the question whether a fixed coverage level for all European DGSs is the optimal choice in a context of national DGSs (v).

i. Arguments against high coverage level: moral hazard

16.The moral hazard problem. As old as the introduction of the first DGSs is the question to what extent the benefits for banking stability are undermined by a moral hazard problem, which affects both depositors and banks.

The reasoning is that in the absence of deposit guarantee systems, *depositors* have an incentive to deposit their money with a stable and secure credit institution with a low chance of default, even if this credit institution does not offer the highest interest rate in the market.[48] Depositors would moreover be motivated to monitor the risk behavior of their credit institution and if necessary withdraw their deposits as a sanction for credit institutions overly exposing their deposits to risk.

By introducing a deposit guarantee system, this incentive disappears. On the contrary depositors may even reward credit institutions engaging in risky behaviour. To the extent deposits at risk are protected by a well-functioning DGS, risk of default becomes irrelevant for depositors in determining their choice of credit institution. One of the most relevant determinants then becomes the interest rate offered on deposits.[49] Highly leveraged credit institutions might be the more profitable ones, being both able and willing to offer higher interest rates for deposits.[50]

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[47] Art. 6 (2). Those exceptions reflect existing exceptions in several member states, see Impact Assessment (n 8) 12.

[48] European Commission, 'JRC Report under Article 12 of Directive 94/19/EC as amended by Directive 2009/14/EC' (2010) (hereinafter referred to as the "JRC Report"), at 201.

[49] House of Commons, Treasury Committee, 'The run on the Rock' (Fifth Report of Session 2007-08) Volume I, at 89, referring to the Treasury and Civil Service Committee (Second Report of Session 1992-93) HC 250, 27.

[50] Naturally, divergences in interest rates set by national banks of EU Member States may also cause cross border flows of deposits, for instance from banks in the Eurozone to non-Eurozone Member States.

Under these assumptions *credit institutions* have an incentive to increase risk-taking in order to be able to participate in the interest rates-led competition for depositors.[51]

The introduction of a DGS would thus have an adverse impact on the prudent behaviour of depositors and banks and therefore increase the chance of collapse of individual credit institutions and of the banking system as a whole.[52] There is some empirical support for this line of reasoning.[53] It has therefore been argued that there are better ways to protect depositors and that deposit guarantee systems should not exist.[54]

17.Importance of the moral hazard argument. The relevance of the moral hazard reasoning has been downplayed on the other hand with the argument that the majority of depositors do not have the expertise to effectively monitor the risk level of banks. The introduction of a DGS and the conditions attached to its guarantees would therefore have little impact on the behaviour of depositors.[55] As bank behaviour is indirectly steered by the behaviour of depositors, banks would equally be unlikely to conduct their business less prudently on account of a DGS being in place.[56]

The pre-crisis period however evidenced that, even if the majority of depositors is indeed not able to monitor bank risk, competition on the basis of interest rates did take place.[57] Competition as such is not necessarily bad. On the contrary the European Union encourages competition as a driver for better conditions for customers. If depositors are unable to monitor banks, it is however, especially in a context of fierce competition, all the more important that

[51] House of Commons, Treasury Committee, 'The run on the Rock' (Fifth Report of Session 2007-08) Volume I, at 89, referring to the Treasury and Civil Service Committee (Second Report of Session 1992-93) HC 250, 27.

[52] Bernet and Walter (n 8) at 9; JRC Report (n 48) at 201.

[53] A Demirgüç-Kunt and E Detragiache, 'Does deposit insurance increase banking system stability? An empirical investigation' (2002) 49 *Journal of Monetary economics*, 1373-1406. The authors conclude that explicit deposit insurance tends to be detrimental to bank stability, even more so where bank interest rates have been deregulated and where the institutional environment is weak. Where institutions are solid – meaning that there is more effective prudential regulation and supervision – they find that opportunities for moral hazard are more limited. The negative impact of deposit insurance on bank stability tends on the other hand to be stronger the more extensive is the coverage offered to depositors, where the scheme is funded, and where the scheme is run by the government rather than by the private sector.

Önder and Özyildirim on the contrary find that "*bank depositors and borrowers reacted negatively to risky banks and punished them even more during the period of generous government guarantee*". Z Önder and S Özyildirim, 'Market Reaction to Risky Banks: Did Generous Deposit Guarantee Change it?' (2008) 36 World Development 1415. The authors however also describe how the deposit insurance system had been changed numerous times during the decade preceding the period of their study (at p. 1418) and indicate (at p. 1420) that "*political and economic uncertainties undermine the credibility of the premises of governments to depositors, and hence, market reaction strengthens significantly*". This seems a very important caveat to their conclusion, which is, regrettably, not repeated in the conclusions of their study.

[54] Campbell and Cartwright (n 7) at 96, with further references.

[55] For an elaborate argumentation with further references: J Hamilton, 'Depositor protection and co-insurance after Northern Rock: less a case of moral hazard and more a case of consumer responsibility?' in J Gray and O Akseli, *Financial Regulation in Crisis?* (Edward Elgar 2011) 19-30; JRC Report (n 48) 201; House of Commons, Treasury Committee, "The run on the Rock" (Fifth Report of Session 2007-08) Volume I, at 90, with further references.

[56] JRC Report (n 48) 201.

[57] Many depositors from the UK, the Netherlands and Luxembourg were e.g. attracted to Icesave which offered much higher interest rates – up to more than 6%) than credit institutions in these Member States. See e.g. S Bowers, 'Court rules against UK in £2.3bn Icesave deposit guarantees battle' Guardian (London 28 January 2013): "*Between October 2006 and October 2008 thousands of UK savers had rushed to open Icesave accounts, lured by market-beating interest rates*".

See also S Schick, "Expanded Guarantees for Banks: Benefits, costs and exit issues" (2009) 2 OECD Financial Market Trends at 13, referring to ECB, 'EU banks' funding structures and policies' (May 2009).

banks are subject to strict prudential rules, compliance with which is carefully monitored by a competent supervisor (see also nr. 21).[58]

18.Moral hazard and coverage level. In spite of the moral hazard argument, the vast majority of developed markets have introduced some kind of deposit guarantee system.[59] Nevertheless, awareness of the moral hazard argument has led to a widespread rejection of a full coverage deposit guarantee system.[60] Depositors would still exercise due care in selecting a credit institution if their deposits are not *fully* protected by a deposit guarantee system.

The moral hazard discussion was indeed an explicit argument in determining the coverage level of Directive 94/19/EC. The Commission considered that "*The minimum level of coverage … should not be too high in order to avoid what has occurred in the United States in particular, where the risks taken by individual depositors have been lowered so much that such depositors have become virtually indifferent to the soundness of their credit institutions ….*"[61]

19.Partial deposit guarantee. Another option discussed in this context is to set a percentage limit for repayment of deposits at risk, so that for every deposit only a percentage (e.g. 90 %) of the deposited amount would be paid out, up to a certain maximum (e.g. EUR 100, 000). The advantage of this system is again that every depositor still has an incentive to use his common sense in selecting a credit institution, which would help preventing depositors to carelessly opt for credit institutions offering the highest interest rates, regardless of their soundness.[62]

Common arguments against a partial deposit guarantee are that depositors would in case of insolvency only get back a percentage of their deposits (up to the guaranteed amount), thus still having an incentive to withdraw, albeit smaller than in the absence of a deposit guarantee system. A partial guarantee is therefore considered ineffective to prevent a bankrun.[63]

The possibility to set a percentage limit for repayment was considered but rejected in the 92 Proposal. Directive 94/19/EC however allowed Member States to introduce such systems[64], which several Member States chose to do.[65]

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[58] See also Demirgüç-Kunt and Detragiache (n 53).

[59]A 2012 FSB report mentions that 21 out of its 24 members operate a DGS, with the exception of China, South Africa and Saoudi Arabia (see FSB (n 31) at 14). Meanwhile South Africa has introduced a DGS according to the website of the International Association of Deposit Insurance (IADI).

[60] See Basel Committee on Banking Supervision – International Association of Deposit Insurers, 'Core Principles for Effective Deposit Insurance Systems. A methodology for compliance assessment' (December 2010) at 22: "*The level of coverage should be limited but credible*" and at 23: "*Blanket guarantees can have a number of adverse effects if retained too long, notably moral hazard*."

[61] Explanatory memorandum to the H92 Proposal (n 34) at 5.

[62] This was the argument made in the UK for introducing a partial guarantee of 75 % of the deposits of any depositor, up to, at the time 20 000 £. See House of Commons, Treasury Committee, "The run on the Rock" (Fifth Report of Session 2007-08) Volume I, at 89, referring to the Treasurey and Civil Service Committee, Second Report of Session 1992-93, HC 250, 27; also Campbell and Cartwright (n 7) at 100.

[63] Campbell and Cartwright (n 7) at 100; Schich (n 18) at 70; JRC Report, n 48 above, at 201; Kleftouri (n 19) at 103; House of Commons, Treasury Committee, The run on the Rock, Fifth Report of Session 2007-08, Volume I, 90, with further references. See also JC Trichet, Keynote speech at the second symposium of the ECB-CFS research network on 'Capital Markets and Financial Integration in Europe' (13 February 2008).

[64] 92 Proposal (n 24) at 6 stated: "*While the proposal was being prepared, the question arose of whether it might be preferable to set a percentage limit for repayment which would be more egalitarian but less protective of small depositors. This solution was not adopted because it would have led to very major changes in some solidarity schemes which take responsibility for rescuing the failing institution and therefore compensate its depositors in full… A compromise was struck making it possible to limit the guarantee to a percentage of the deposit but requiring that this*

20. Don't put all your eggs in one basket. It could be argued that there is a certain merit in setting a coverage level which leaves a substantial number of depositors not fully covered. The most extreme moral hazard effect where depositors are inclined to put *all* their deposits – irrespective of the amount – with the institution offering the highest interest rates, would thus be avoided. Depositors would on the contrary have an incentive to spread their risk over different credit institutions, which in itself is beneficial for competition in the market.[66] Even if in times of banking stability, most depositors may not be so prudent, in times of generalised insecurity depositors will have more incentives to spread their deposits and not have more deposits than the coverage level at any bank. Chances that a bank run would be caused by mere rumours about a bank facing financial difficulties, would then be reduced, even without granting full coverage.

During the crisis many depositors indeed started spreading their deposits to ensure not to hold more than the coverage level with the same bank. Although the term "partial bank run" would exaggerate the phenomenon, many people did withdraw the amounts exceeding the coverage level from their bank, to deposit it with one or more other banks.[67]

21.Recent considerations. Some studies confirming the moral hazard problem notwithstanding,[68] the evolution since the crisis has been, abroad as in the EU, to strengthen the deposit guarantee system and increase its coverage level.[69] The moral hazard is increasingly set aside, arguing that this problem should be counterbalanced by an increased focus on default prevention and supervision.[70] The supervisor is then considered taking the place of individual depositors in monitoring credit institutions. The first and the third pillar of the banking union are therefore intrinsically linked: supervision should prevent the need to make much use of the third pillar. The third pillar backs up for the first's failures.

ii. Arguments in favour of a high coverage level

22.Depositor Confidence. The main reason why the vast majority of developed financial systems have deposit guarantee systems, is that by explicitly protecting depositors' balances, a deposit guarantee system should increase depositor confidence in the financial system and thus contribute to the stability of the financial system. It has been argued that he higher the level of coverage offered by the deposit guarantee system, the more effective the deposit guarantee system would be in reaching the financial stability goal.[71]

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covers at least 90% of deposits, up to a payment of 15 000 EUR. Above this limit, Member States or schemes remain free to provide for lower payment ratios or even to refuse any guarantee whatsoever".

[65] Such as most notably the UK, which however abolished this co-insurance system during the crisis. See Kleftouri (n 19) at 102 and following.

[66] Impact Assessment (n 8) at 11, claiming that splitting up deposits and opening of accounts at several banks in this way, could actually enhance competition.

[67] During the public consultation preceding the adoption of the Directive, on request only anecdotal evidence has been provided of this phenomenon. See Impact Assessment (n 8) at 11. A 2008 FSA consultation document nevertheless noted: "*that some customers are moving their savings to reduce the amount they have in a particular institution down to the limit*." See Financial Services Authority, 'Compensation Scheme: Review of Limits' (October 2008) CP 08/15, at 14, para 3.3.

[68] Subject to conditions and caveats, see footnote 53.

[69] FSB (n 31) at 10.

[70] See IADI 2009 Principles (n 7) at 8-9, para 16, see also Principle 1 and the explanation at p. 9. This was confirmed in an empirical study that found that in countries with a very good institutional environment deposit insurance may not lead to additional instability, perhaps because in those countries regulators can more effectively offset moral hazard (Demirgüç-Kunt and Detragiache (n 53).

[71] JRC Report (n 48) at 198.

The conviction that a high coverage level is beneficial to financial stability clearly influenced the European legislator. The 92 Proposal already stated that "*coverage must not be too low and leave too many deposits outside the minimum threshold of protection*."[72]

Interesting to note is also that the Commission at that time would have preferred to fix the minimum level of coverage on the basis of exact data. As it however did not have empirical evidence at its disposal on the size and distribution of accounts, the Commission deemed it reasonable to try and establish a minimum level of coverage for the community, roughly based on the levels of coverage adopted by guarantee schemes in Member States at the time.[73]

23.Full coverage for majority of depositors. The occurrence of several bankruns during the crisis has further strengthened the idea that only a coverage level which guarantees full coverage for a vast majority of depositors is effective to prevent bankruns.[74] The European standardised protection of EUR 100, 000 clearly fits this tendency. It has been based on the objective not to leave "*too great a proportion of deposits without protection in the interests both of consumer protection and of the stability of the financial system*".[75] In view of the ambition to create a meaningful protection in *all* Member States, the harmonised coverage level has been set at a level ensuring credibility also in Member States with the highest average household deposits.[76]

The even higher coverage level for temporary high balances is also in line with this idea.

iii. Cost considerations

24.Cost considerations. If full coverage for a majority of depositors can be considered to be the new paradigm, in the recent European legislative process it has been limited only by cost considerations. In Directive 2014/49/EC the moral hazard argument – which was explicitly mentioned in Directive 94/19/EC[77] – has been deleted as a justification for limiting the coverage level to EUR 100,000. Instead, only a purely economic and *real politic* argument has been maintained: the cost of funding.[78]

25.Direct link between coverage and funding. Directive 2014/49/EU introduces the principle that the minimum funding level of the DGS is explicitly linked to the total amount of covered deposits (see nr 76). The higher the coverage level, the higher should the contributions from the banking sector to the guarantee fund be.

Clear cost calculations are therefore at the basis of setting the coverage level of EUR 100,000 in Directive 2014/49/EU. The coverage level of EUR 100,000 was chosen as "*the balanced solution in terms of cost/benefit efficiency since the costs increase more or less proportionally in all scenarios … while the benefits of adopting a higher coverage level than € 100 000 are very limited*". While further increasing the coverage level would still bring substantial benefits in

[72] Explanatory memorandum to the 2010 Proposal (n 34) at 5. See also recital 16 of Directive 94/19/EC.
[73] *Ibid*.
[74] Schich (n 18) at 69-70. See Basel Committee on Banking Supervision – International Association of Deposit Insurers, 'Core Principles for Effective Deposit Insurance Systems. A methodology for compliance assessment' (December 2010) at 16: "*The level of coverage is limited but credible (eg the level of coverage is high enough to maintain confidence, but limited to maintain market discipline). … It should cover adequately the large majority of depositors to meet the public policy objectives of the system*".
[75] Recital 21.
[76] Impact Assessment (n 8) at 10, describing why even a coverage level of 50 000 EUR would still be dangerously low.
[77] Recital 18, see also nr. 16.
[78] Compare recital 16 of Directive 94/19/EC with recital 21 of Directive 2014/39/EU in this respect. The cost of funding is discussed in more detail in section IV below.

terms of increasing the *amount* of covered deposits, it would only marginally – "*almost negligibly*" – increase the *number* of fully covered deposits.[79]

The previous level of coverage of EUR 50,000 was nevertheless deemed insufficient since "*even before the crisis (in 2007), the average household deposits amounted to more than €50 000 in at least five Member States and were only slightly below this amount in two other Member States*" and "*only 91% of the number of eligible deposits would be covered*", meaning that "*at least 9% of depositors are likely to run on a bank*".[80]

A lower coverage level than 100 000 was moreover deemed inconceivable as such could negatively influence both depositor confidence and financial stability in view of the fact that 16 Member States had either already applied the coverage level of at least €100 000 or had legislation in place stipulating the introduction of such a level of coverage in 2010.[81]

Full coverage has been dismissed "*given that it is not possible to adjust the target level of funding if the coverage level is unlimited*" (recital 23).[82]

26.Adaptable standard. Either way, a considerable improvement compared to the previous directive is that the coverage level can be easily adapted to inflation levels at the initiative of the European Commission. This may prevent that the delicate balance sought by the determination of the coverage level at EUR 100,000 would be inflated away.

iv. Regulatory competition

27.Regulatory competition. Already in Directive 94/19/EC certain rules were in place to prevent the risk of competition on the basis of deposit guarantee conditions.[83] In view of the experiences

[79] Impact Assessment (n 8) at 33. The tables in annex 3 (p 104-105) show that with a coverage level of 100 000 EUR, 71,8% of the *amount* of deposits in the EU would be covered, which would increase to 81% and 88,4% if the coverage level were to be increased to 150 000 c.q. 200 000 EUR. A coverage level of 100 000 EUR would on the other hand cover 95,4% of the *number* of deposits in the EU, which would increase to 96,5% c.q. 97,2% if the coverage level were to be increased to 150 000 EUR c.q. 200 000 EUR.

[80] The Impact Assessment in this context refers to the Basel Committee considering deposits as "unstable" if there is a "run-off factor" of 7,5 % of depositors, concluding that a coverage level at EUR 50 000 would be dangerously low (see Impact Assessment (n 8) at 10). This reasoning is however flawed. The Basel Standards require that for the calculation of the LCR ("liquidity coverage ratio") introduced in the Basel III Standards, account should be taken of the risk of run-off of a proportion of the depositors in cases of a combined idiosyncratic and market-wide shock. For 'stable' deposits – which are fully covered by a deposit guarantee fund and fulfill certain other conditions – this run-off factor was determined at minimum 5%, meaning that in a period of stress the bank will lose 5% of those deposits in the next 30 days. For unstable deposits – not fully covered or not fulfilling some other conditions – the run-off factor was determined at minimum 10% (in an earlier version 7,5%), meaning that in periods of stress the bank should take into account a loss of 10% of those deposits in the next 30 days. This is quite something different than stating that deposits are unstable if there is a run-off factor of 7,5% of depositors. The Impact Assessment refers to the Basel Committee on Banking Supervision, 'Basel III: International framework for liquidity risk measurement, standards and monitoring' (December 2010, updated January 2013) at 12-13, nrs 54-61.

[81] Impact Assessment (n 8) at 32; European Commission, 'Report to the European Parliament and to the Council – Review of Directive 94/19/EC on DGSs' (12 July 2010) COM(2010)369 final, at 3.

[82] This line of reasoning seems incorrect. If the amount of coverage would be unlimited, the amount of covered deposits would equal the amount of eligible deposits. The funding of EU DGSs should then indeed increase and this would be costly, but it would not be impossible to adjust the target level of funding.

[83] So called "topping-up" arrangements provided that branches of credit institutions in host states with a level and/or scope of cover exceeding the level and/ or scope of cover in the home state, could voluntarily join the host state scheme in order to supplement the guarantee which its depositors already enjoy by virtue of its membership of the home Member State Scheme. On the other hand neither the level nor the scope, including the percentage, of cover provided by the home member state, could exceed the maximum level or scope of cover offered by the corresponding guarantee scheme within the territory of the host Member State (art. 4 and recitals 13 and 14 of

during the crisis, these measures were no longer deemed sufficient (see nr 8). In order to create a level playing field for all credit institutions in the European Union and to prevent regulatory competition a maximally harmonised coverage level was deemed necessary.[84]

28.Need for one fixed coverage level for the EU? Whether the regulatory competition argument carries enough weight to introduce a fixed coverage level, can however be questioned.

The standards of living indeed differ quite substantially in different Member States of the European Union.[85] A EUR 100,000 threshold would therefore leave quite a proportion of deposits without protection in some Member States, impacting the credibility of the deposit guarantee system in those states,[86] whereas it represents a full guarantee for virtually the entire population in other Member States.[87]

Relatively speaking the fixed coverage does therefore not create a uniform degree of depositor protection.[88] Moreover, in view of the different standards of living and the different saving habits in the different Member States, a uniform coverage level carries an intrinsic element of unfair competition. Since bank contributions to the DGS are calculated on the basis of covered deposits (and not on the basis of eligible deposits), credit institutions in less wealthy Member States will need to contribute relatively more than credit institutions in wealthier Member States.[89]

As DGSs are today functioning at Member State level, the question whether the European coverage level covers a majority of deposits in *Europe* seems irrelevant for banking stability in that Member State.[90]

29.Alternative? This however does not mean that European harmonization of the coverage level should be abandoned. It would have been feasible to express the coverage level as an amount ensuring full coverage of a certain percentage of depositors. However, such options based on "*selected financial or economic indicators, e.g. the size of deposits or GDP per capita have been discarded at an early stage*".[91] The reason seems to have been that such an approach would

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Directive 94/19/EC). In order to prevent competition on the basis of coverage level of the DGS, Directive 94/19/EC further provided limitations on references to amount and scope of a deposit-guarantee scheme in advertising (art. 9 (3) and recital 22 of Directive 94/19/EC).

[84] JRC Report (n 48) at 199; Impact Assessment (n 8) at 31; European Commission, 'Report to the European Parliament and to the Council – Review of Directive 94/19/EC on DGSs' (12 July 2010) COM(2010)369 final at 2-3.

[85] The Directive explicitly refers to those differences in living costs. Recital 39 argues that, given the different living costs between the Member States, it is the Member States which should determine the appropriate amount of covered deposits to which depositors should have access to for covering their costs of living in the event of failure of their credit institutions during the transitional period until the payout period is reduced to 7 working days (see nr 17). See also Impact Assessment (n 8) at 45, considering the option of introducing a "de minimis" level for payout for very small deposits, under which no payout would have to be made: "*… keeping in mind the different purchasing power in Member States, it might be perceived in one Member State as irrelevant but in the other Member State as not negligible*."

[86] With a coverage level of 100 000 EUR only 74,67% of eligible deposits are fully covered in Sweden, 78,85% in Cyprus, 81,22% in Danmark and 84,29% in the UK.

[87] With the same coverage level however 99,42% of eligible deposits are fully covered in Bulgaria, 99,98% in Estland, 99,41% in Hungary and 99,87% in Romania.

[88] Compare Kleftouri (n 19) at 114.

[89] For the sake of the argument abstraction is made of the fact that a risk factor is taken into account in the calculation of contributions of individual credit institutions. See nr 76.

[90] In a pan-European system this would be appropriate (see nr 93 and 95).

[91] Impact Assessment (n 8) at 31.

have resulted in different coverage levels in different Member States, which was considered undesirable in view of the experiences during the crisis.[92]

The context would however be different if coverage would be harmonised at a level ensuring that a minimum percentage of deposits /depositors is fully covered (e.g. minimum 98% of depositors is fully covered). As the vast majority of depositors would be fully covered, they would have no incentive to transfer money to Member States with a higher coverage level. This risk would only exist for the small minority of depositors whose deposits are not fully covered. A harmonised coverage level expressed as an amount ensuring that a given percentage of depositors is fully covered, would thus be better adapted to the actual standards of living and average household savings in each Member State.

A disadvantage of this system would be that the coverage level becomes a variable amount which would have to be regularly updated on the basis of accurate data. This could create uncertainty for depositors as what the applicable coverage level is and might negatively impact depositor confidence. This problem could be solved by setting a harmonised minimum coverage level, which every Member State would adapt e.g. every year, but only upwards, in order to ensure that a harmonised percentage of depositors is fully covered.

A harmonised fixed coverage level for the European Union therefore does not seem to be necessary to achieve banking stability and depositor protection. A level playing field between banks does not depend on it, nor would its absence necessarily give rise to regulatory competition.

A more valid reason for opting for a fixed harmonised amount, as the Directive did, is to consider the Directive as a first step towards a pan-European DGS, prerequisite of which would be full harmonisation of national DGSs. [93]

IV. Payout period

a. Rule

30.Determinants. As for the payout period, there are two key determinants: its starting point and its duration.

31.Starting point. Before Directive 94/19/EC was implemented in the Member States, most Member States with a DGS provided for a more or less prompt payout to depositors. Payout was however tied to the progress of liquidation procedures, which often led to substantial delays, depositors' distress and numerous disputes.[94]

Directive 94/19/EC therefore introduced a starting point for the payout period which was not linked to an insolvency procedure. This has remained the same under the new Directive. The starting point for the payout period is the date on which a deposit has been declared

[92] Impact Assessment (n 8) at 31.
[93] See the IADI 2009 Principles (n 7), explanations and supporting guidelines to principle 9, at 13, stating that the same coverage limit should apply to all banks in the DGS.
[94] 92 Proposal (n 24) at 6.

"unavailable" in accordance with an official determination by the relevant administrative authorities or a ruling from a judicial authority.[95]

The relevant administrative authorities should make that determination as soon as possible. Under Directive 94/19/EC this meant at the latest 21 days after first becoming satisfied that a credit institution has failed to repay due and payable deposits. This term has been reduced to 5 working days by Directive 2009/14/EC and has remained the same under the new Directive (art. 3 (2)).

32.Payout period of 7 working days. Directive 94/19/EC provided that payouts had to be completed within a three-months' timeframe (except in case of special circumstances).[96] This timeframe was based on the practical experience of managers of such schemes.[97]

Interestingly, a Parliament amendment to reduce the time limit from three to two months was rejected by the Commission arguing that "*it is in any case extremely short given the verification operations which have to be carried out before making payments. The checks may be made very long and difficult by the disorder often encountered in the accounts of credit institutions which are in crisis*."[98]

Nonetheless the subsequent Directive 2009/14/EC reduced the payout period to 20 working days.

Five years later, a further, radical reduction of the payout period to 7 working days was adopted (article 8 (1)): the DGS should ensure that the repayable amount is available within 7 working days of the starting point (art. 8 (1)). This payout period is not dependent on a payout request of the depositor.

In order to ensure payout within this sharp timeframe, the Directive requires the credit institution to transmit the necessary information on deposits and depositors as soon as requested by the DGS (art. 8 (6)).

b. Exceptions

i. Exception 1: transitional period

33.Transitional period. The European legislator seems to have realised that the reduction of the payout period to 7 working days is not self-evident. Therefore the Directive allows Member States to introduce a considerable transitional period, gradually reducing the payout period.[99] The payout period of 7 working days is mandatory as from 1 January 2024.

[95] It means that a deposit that is due and payable has not been paid by a credit institution under the applicable legal or contractual conditions and where (i) the relevant administrative authorities have determined that in their view the credit institution concerned appears to be unable for the time being, for reasons which are directly related to its financial circumstances, to repay the deposit and to have no current prospect of being able to do so or, (ii) a judicial authority has made a ruling for reasons which are directly related to the credit institution's financial circumstances and which has the effect of suspending the rights of depositors to make claims against it (i.e. a ruling in a bankruptcy or debt suspension procedure), should that occur before the aforementioned determination has been made (art. 8 (1) and 2 (8)).

[96] Art. 10.

[97] 92 Proposal (n 24) at 6.

[98] European Commission, Amended Proposal for a Council Directive on Deposit-Guarantee Schemes, COM(93)253, Explanatory Memorandum at 7.

[99] To 20 working days (until 31 December 2018), 15 working days (until 31 December 2020) and 10 working days (until 31 December 2023) (article 8 (2)).

34. 5 working days payout period for costs of living. During this transitional period European DGSs should ensure that, if they cannot make the repayable amount available within seven working days, depositors should have access, within five working days, to an appropriate amount of their covered deposits to cover their costs of living.

Such appropriate amount for living expenses is, however, only paid out upon request of the depositor. This request is the starting point for the 5working days period.

Access to such an "appropriate amount" shall only be granted on the basis of data provided by the DGS or the credit institution and shall obviously be deducted from the repayable amount (article 8 (4)).

The Directive does not give guidance on how to determine what "an appropriate" amount to cover the cost of living would be. Recital 39 indicates that this amount should be determined by the Member States, given the different living costs in the Member States.

ii. Exception 2: Deferral of payout

35.Reasons. As from 1 January 2024, the 7 working days period can only be deferred on the basis of one of the five exceptions indicated in article 8 (5), among which (i) uncertainty whether a person is entitled to receive repayment; (ii) the deposit being subject to legal dispute; (iii) the amount to be repaid deemed part of a temporary high balance or (iv) the amount to be repaid is part of a deposit at a branch in another Member State, to be paid out by the DGS of the host Member State in accordance with article 14(2).[100]

36. 35bis. No payout period determined. The Directive does not give any indication of a maximum payout period in such cases.

c. Evaluation in view of economic / law and economics arguments

37.Depositor confidence requires short payout period. From a stability perspective a short payout period is key. Indeed, reassurance of depositors that their money is safe under any circumstances (up to the covered amount), will not be achieved if depositors still risk facing a long period of unavailability of their deposits before repayment.[101]

38.How short? To what extent a payout period can be shortened, will mainly depend on the question how fast the necessary information on covered deposits is made available to the DGS. Increased use of computer systems has indeed allowed a dramatic reduction of the payout period.

A payout period of seven working days is however extremely short. It means that DGSs will need to take action immediately upon the determination of unavailability of deposits by an administrative authority[102] or upon the ruling suspending depositors' ability to make claims against the credit institution by a judicial authority. It also implies that credit institutions will need to have all information on depositors and their covered deposits readily available.

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[100] See art. 8 (5) a) and d).
Repayment may further be deferred where:
(b) the deposit is subject to restrictive measures imposed by national governments or international bodies;
(c) there has been no transaction relating to the deposit within the last 24 months (the account is dormant).

[101] Kleftouri (n 19) at 116; JRC Report (n 48) at 2.

[102] See also the IADI 2009 Principles (n 7) principle 17: "… *the deposit insurer should be notified or informed sufficiently in advance of the conditions under which reimbursement may be required and be provided with access to depositor information in advance*."

39.Steps towards payout. In this very short payout period the following actions need to be taken by the different parties involved:

- The DGS should request the necessary information on depositors and their deposits from the defaulting credit institution.
- The credit institution should assemble this information and provide it to the DGS.
- On the basis of the information received from the credit institution, the DGS has to determine the right to payout for each depositor.
- The DGS has to proceed to payout.

40.DGSs' resources. In order to ensure timely payout DGSs will need to dispose of sufficient human and technical resources, which would at present not in all cases be ensured.[103]

41.Key role for credit institution – lack of regulatory framework. It is clear that the credit institution also plays a crucial role in realising this short-term payout procedure.

The Directive however does not provide for rules on the timeframe for the credit institution to react to a DGS's request, other than that "the necessary information" shall be transmitted "as soon as requested by the DGS". Moreover the Directive does not include any sanctions for untimely and / or incomplete or incorrect transfer of information.

It is further not clear what exact information and what level of detail should be provided by the credit institution. Information on deposits and depositors should in principle be readily available at all times, since anonymous accounts are forbidden.[104] This information as such however does not automatically result in adequate information for payout purposes under the Directive.

The DGS needs to dispose of aggregated information concerning each individual depositor.[105] Not only should the sum of each depositor's personal saving, current and other accounts be made,[106] but also his or her part in a joint account or in an account of a partnership without legal personality has to be added. Further the rights of economic versus beneficial owners (e.g. usufruct or vs naked property) should be determined. Often the entitlement of a depositor on a certain deposit is moreover not entirely clear for other reasons: is there a right of set-off?[107] Is a certain deposit the subject of dispute? Or has it been pledged as a security for the credit institution or a third party?

For each depositor should further be determined whether he or she can benefit from the temporary high balance exception (nr 35), which in itself is a reason for deferring payout (art. 5 (e)).

[103] Impact Assessment (n 8) at 16.
[104] Article 6 (1) of Directive 2005/60/EC on anti-money laundering and terrorist financing.
[105] Guarantee per depositor rather than per deposit (see nr 9 above).
[106] See the definition of "deposit" in art. 2(3).
[107] See article 7 (5), which gives Member States the option to decide that the liabilities of the depositor to the credit institution are taken into account when calculating the repayable amount, where they have fallen due on or before the starting point of the payout period and to the extent the set-off is possible under the statutory and contractual provisions governing the contract between the credit institution and the depositor. A study from Ernst & Young however came to the conclusion that the net based payout approach would be significantly more expensive given de additional data requirements and calculations. See Ernst and Young, 'Fast payout study – final report' (November 2008) at 2.

These checks are not only potentially timeconsuming, the Directive moreover does not take a clear stance on who is responsible for making this complex exercise. In practice much of the relevant information will necessarily need to be gathered by the credit institution: the credit institution has entered into the deposit contract in respect of joint accounts, indicating the share of each depositor in the joint account; the credit institution will have been notified of a pledge on account; the credit institution has the data on movements in the latest 3 to 12 months in order to allow checking whether the temporary high balance exception may apply.

42. Short payout period requires increased systematisation. Further guidance from supervisory authorities on the exact duties of credit institutions in this regard seems necessary. During the transition period which Member States can introduce for reducing the payout period (nr 33), credit institutions should in any event get sufficient time to invest in new and improved applications to ensure prompt delivery of the necessary data. This however involves high costs for credit institutions. They will need to invest in electronic eligible account flagging to enable quick identification of those depositors who are entitled to claim under the DGS. Total costs of this investment have been estimated at EUR 1.7 bn. Credit institutions should further be able to create a "Single Customer View" which offers a reliable and consistent view of eligible depositors' aggregate deposits. Costs have been estimated at EU 3.5 bn. In order to allow the creation of such a Single Customer View "data cleansing" systems are needed, in order to clean and maintain customer data such that all eligible accounts of the same customer can be identified and matched. Total EU costs for data cleansing have been estimated at around EUR 1.1 bn. [108]

It is however questionable whether the process of determining each depositor's exact position can be completely automated. For example, with respect to temporary high balances, the system could flag unusually high balances, but verifying whether an unusually high balance is indeed a temporary high balance qualifying for an increased coverage level under article 6 (2), is likely to require a manual and therefore time-consuming check. Article 8 (5) d) understandably creates an exception to the 7 working days payout period for this situation. It seems reasonable to apply the extension of the payout period in these circumstances only to the surplus of EUR 100,000. There is no reason to delay payout of the amount up to EUR 100,000.

43.Moral hazard – ample use of exceptions? The very short payout period could cause deposit guarantee systems to make ample use of the exceptions of article 8 (5) (see nr 35). Every minor complication or uncertainty could be seized to resort to one of the deferral possibilities, especially under article 8 (5) (a), "*uncertainty whether a person is entitled to receive repayment*". Also deposits at branches in other Member States risk systematic deferral of payout under 8 (5) (e).

The very short repayment period of seven working days may therefore have as a consequence that only depositors of home state branches with entirely uncomplicated and straightforward deposits will be paid out in time.

Especially the deferral of the payout period for deposits of branches in other Member States is contrary to the internal market philosophy and could indeed work as an impediment for branches to fully develop.

44.No maximum payout period determined if exceptions apply. All the more worrying is that no maximum payout period has been determined in case of deferral under one of the exceptions of

[108] JRC Report (n 48) at 5, and Ernst and Young, "Fast payout study – final report" (November 2008) at 2, 8 and 9.

article 8 (5). The larger the proportion of depositors that is not paid out within the ordinary time frame, the more the reassurance function of the short payout period will be undermined.

45. 5 working days payout of an appropriate amount during transitional period. In the preparatory documents to the Directive the option to provide for an "emergency payout" in advance of the full payout for which a much longer period would apply, was dismissed, because it would almost double the work and costs for DGSs, and it could result in a higher than normal rate of erroneous payments, resulting in further costs for DGSs in trying to recover such payments. The conclusion was that if an emergency payout could take place, payment of the full amount should also be possible within a short deadline if the DGS is soundly financed.[109] This "emergency payout" idea nevertheless seems to have found its way into the Directive through the exception for living expenses during the transitional period. The fact that a DGS only has to proceed to payout of an appropriate amount for living expenses *upon request* of a particular depositor, may nevertheless temper the increase in work load.

46. "Working days". The term "working days" has not been defined in the Directive. It seems logic that weekends and official holidays should not be considered working days. It can further be assumed that working days should be calculated in accordance with the home Member State calendar. In certain Member States there are however more so-called "bank holidays" than official holidays. In view of the important role of the defaulting credit institution in the payout process (see nr 40), it seems reasonable to also disregard those bank holidays as working days. This may however mean that in certain periods and certain Member States, the actual repayment period can be more than 11 days. For foreign depositors, unaware of home state banking holidays, this may create uncertainty on the actual repayment period,[110] not helping in creating the necessary confidence in the DGS.

V. Funding

a. Principles

47. Need for sufficient funding. In order to inspire confidence, DGSs should be sufficiently funded to be able to make the necessary payouts within a short timeframe.[111] Funding however also represents a costs for credit institutions as financiers of the fund, raising difficult questions as to when the funding should be provided, what an adequate level of funding would be and how the contribution of each participating credit institution should be calculated.

48. Historic evolution. Funding of DGSs was not covered by the 87 Recommendation and was explicitly not the subject of harmonization in Directive 94/19/EC, as "*[a]fter receiving the assurance that the financing arrangements were sufficiently sound to pay off all depositors covered, including those at branches in another Member State, it was not considered necessary to harmonize rules which are closely linked with the management of the schemes in question*".[112]

The 23th recital of Directive 94/19/EC only mentions with respect to funding "*that the cost of financing such schemes must be borne, in principle, by credit institutions themselves and … that*

[109] European Commission, 'Report to the European Parliament and tot the Council – Review of Directive 94/19/EC on DGSs' (12 July 2010) COM(2010)369 final, at 5.
[110] See also Impact Assessment (n 8) at 17.
[111] See IADI 2009 Principles (n 7), principle 10, at 4; Kleftouri (n 19) at 115.
[112] 92 Proposal (n 24) at 8.

the financing capacity of such schemes must be in proportion to their liabilities; … this must not, however, jeopardize the stability of the banking system of the Member State concerned".

49.Basic principles. Directive 2014/49/EU is based on the same basic principles that the cost of financing DGSs should, in principle, be borne by credit institutions themselves and that the financing capacity of DGSs should be proportional to their liabilities.[113]

The Directive takes a radically different stand however towards the need to harmonise rules on funding of DGSs. It claims that in order to ensure that depositors in all Member States enjoy a similarly high level of protection, the financing of DGSs should be harmonised at a high level with a uniform ex ante financial target level (recital 27).

50.Ex ante versus *ex post funding*. Ex ante funding means that credit institutions pay periodic contributions to the fund to build up resources for payout in case of a bank failure.[114] In order to reduce the cost of ex ante funding[115], several DGSs have allowed for (partial) forms of ex post funding,[116] where credit institutions will need to contribute (only or additionally) when a need for payout arises. DGSs solely based on ex post funding are in fact "unfunded".[117]

51.Three step funding mechanism in Directive 2014/49/EU. The Directive provides for a three step financing mechanism for European DGSs. First a minimum ex ante level of funding should be reached. Second, if this does not suffice to fulfill a particular payout need, credit institutions should pay ex post contributions. The last line of defense against taxpayers involvement[118] are "alternative funding arrangements".

The original 2010 proposal provided for a four step funding mechanism, the third line of defense being a mutual borrowing facility between European DGSs.[119] In the final version of the Directive this borrowing facility has been watered down to such an extent that we hardly consider it a realistic funding arrangement.

These different funding mechanisms are examined in more detail below.

b. Ex ante funding

i. Level of ex ante funding

52.Rule. Every European DGS should reach a target level of ex ante funding of at least 0,8 % of the amount of *covered* deposits of its members.[120] The original proposal aimed at a target level of 1,5 % of *eligible* deposits (eligible deposits are all deposits that are not excluded from protection, see nr 12). The ECB however recommended to define the target level by reference to covered deposits (eligible deposits not exceeding the coverage level, see nr 12) considering

[113] Recital 27 and article 10 (1).
[114] Schich (n 18) at 71.
[115] See on the costs of ex ante funding: Kleftouri (n 19) at 106. The author refers to the opposition from the British Bankers' Association against the introduction of ex ante funding in the British DGS, as "*an ex ante scheme would tie up capital that could otherwise be effectively utilised, causing an unnecessary drain on the liquidity position of banks*."
[116] For an overview, see JRC Report (n 48) at 29.
[117] Schich (n 18) at 71.
[118] National sovereigns de facto or de jure provide a backstop for their DGSs. This can be an official de jure backstop in the form of a credit line (see nr 69) or an implicit guarantee in the context of the "too big to fail problem", where the state will bail-out ailing credit institutions. In both instances taxpayers' money is used as a backstop for the DGS.
[119] Explanatory memorandum to the 2010 Proposal (n 34) at 7-8.
[120] Art. 2 (1)(b) of the 2010 Proposal.

that covered deposits reflect the level of DGSs' liabilities more adequately than eligible deposits.[121]

The target level only aims at minimum harmonisation, since the Directive "*does not prevent Member States from setting a higher target level or providing that a DGS may request member institutions to make ex ante contributions even after the target level is reached*".[122]

53.Transitional period. Many European DGSs do not reach the level of 0,8 % of covered deposits today. The Directive requires that this target is reached by 3 July 2024 (art. 10 (2)).

54.Exception – "too big / interconnected to fail". An exceptional lower target level of at least 0,5 % of covered deposits (the "reduced target level") however suffices for DGSs in Member States where credit institutions operate in a highly concentrated market "*where most credit institutions are of such a size and degree of interconnection that they would be unlikely to be wound up under normal insolvency proceedings without endangering financial stability and would therefore be more likely to be subject to orderly resolution proceedings*" (recital 28).

Upon approval of the Commission, this lower minimum target level can be authorized by Member States upon two conditions (article 10 (6)):

(i) need of actual payout under the DGS is unlikely[123];

(ii) highly concentrated banking sector[124].

This exception has been claimed to be made for the benefit of France,[125] although other Member States, such as Greece, Estonia, Lithuania, Finland and the Netherlands, have much more concentrated banking markets.[126]

ii. Means of ex ante funding

55.Cash, low-risk assets and payment commitments. The financial means of DGSs can consist of cash, deposits, payment commitments and low-risk assets[127] which can be liquidated within a period not exceeding the maximum payout period of 7 working days (recital 34 and art. 2 (1)(12)).

[121] ECB, Opinion (16 February 2011) CON/2011/12 [2011] OJ C99/3.

[122] EBA, Guidelines on methods for calculating contributions to deposit guarantee schemes, EBA/GL/2015/10 at 11, para 21. The DGS can decide to do so "*in order to fulfil the objective mentioned in paragraph 16(c)*", i.e. in order to help mitigating incentives for excessive risk taking by member institutions by having higher contributions paid by riskier institutions; this should also ensure that failed institutions have properly contributed in advance.

[123] The reduction should be based on the assumption that it is unlikely that a significant share of available financial means will be used for measures to protect covered depositors, except to finance the resolution of credit institutions or measures to preserve the access of depositors to covered deposits in the context of national insolvency proceedings (art. 11 (2) and (6)).

[124] The banking sector in which the credit institutions affiliated to the DGS operate, is highly concentrated with a large quantity of assets held by a small number of credit institutions or banking groups, which, given their size, are likely in case of failure to be subject to resolution proceedings.

[125] A Barker, 'EU agrees deposit guarantee scheme deal' FT (18 December 2013). See also Véron referring to France as an example of a large Member State with a concentrated banking sector: N Véron, 'Banking Union in nine questions, written statement for the Interparliamentary Conference under Article 13 of the Fiscal Compact' (30 September 2014) at 12.

[126] See ECB, 'Structural indicators for the EU Banking sector 2013' (January 2014) at 1, table 2 indicating the share of total assets of the five largest credit institutions in each Member State. For Greece this share is 94 %, for Estonia 89,7 %, for Lithuania 87,1%, for Finland 84,1% and for the Netherlands 83,8%. For France this is only 45,9%.

[127] See definition in art. 2(1) (14).

56.Payment commitments. In order to attenuate the burden on credit institutions to make upfront cash contributions to the DGS, contributions can partly consist of payment commitments (art. 10 (3)). These payment commitments should be fully collateralized whereby the collateral (i) consists of low risk assets and (ii) is unencumbered by any third-party rights and at the disposal of the DGS (art. 2(1)(13)). Credit institutions should only make an actual payment under these commitments when the DGS actually has to proceed to payout in accordance with the Directive.

The Directive provides that the total share of payment commitments should not exceed 30 % of the total amount of available financial means of the DGS. The Directive thus only gives guidance on the *maximum share* of payment commitments *in the total amount* of available financial means of the DGS. EBA guidelines however individualise this general 30% maximum to any given member of the DGS: DGSs should not accept more than 30 % of a given member's ex ante contributions in the form of payment commitments.[128] DGSs should implement this mechanism on the basis of non-discriminatory criteria. The possibility to provide contributions in the form of payment commitments should nevertheless not be read as an automatic right for credit institutions.[129]

iii. Evaluation

57.Level of ex ante funding. Research had indicated that the current level of ex ante funding of many DGSs in the European Union is largely insufficient to deal with the failure of a large credit institution.[130] DGSs in 6 Member States would not be capable to cope with a medium-sized bank failure[131] and 6 Member States today even operate DGSs that rely on ex post funding only[132], suffering from the problems described below (see nr 66).

Harmonising a minimum level of ex ante funding is therefore a big step forward. The Directive's ex ante funding level has however been based on payout of depositors of a small to medium-sized credit institutions only.[133] A target of ex ante funding of 0,8 % of all covered deposits will therefore still result in underfunded schemes, unable to cope with the failure of a large credit institution, let alone with multiple failures.

Higher funding levels are however considered too costly for the financial sector[134] and, as it requires the immobilization of substantial amounts of funds, for the economy in general. The Directive has therefore sought to strike a balance between ex ante, ex post and alternative means of funding (see also nr 67).

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[128] EBA, Guidelines on payment commitments under Directive 2014/49/EU on deposit guarantee schemes, EBA/GL/2015/09 at 10, para 8.

[129] Ibid.

[130] JRC Report (n 48) at 55 and following, especially the table at p. 61.

[131] See Impact Assessment (n 8) at 19 and schedules at 129.

[132] JRC Report (n 48) at 31.

[133] In the Impact Assessment, 1,96 % or simply 2 % of *eligible* deposits was considered the most cost-efficient target level, ensuring that DGSs would be credible and capable to deal with medium-sized bank failures (see Impact Assessment (n 8) at 58). In the 2010 Proposal however a target level of 1,5% of eligible deposits was proposed; which was adapted to 0,8 % of all *covered* deposits in the final Directive.

[134] A recent study calculated that a DGS with a target fund equal to 2% of the amount of eligible deposits could cover up to 98,81% of its potential losses. If the DGS wanted to set aside a fund capable to cover up to 99% of its potential losses, it should raise its fund up to 3,2% of the amount of eligible deposits. See S Maccarferri, J Cariboni and W Schoutens, 'Lévy Processes and the Financial Crisis: Can We Design a more Effective Deposit Protection?' (2013) International Journal of Financial Research at 15.

The problem of underfunding should moreover be put in context. In financial stability threatening situations the second pillar of the Banking Union will come into play, providing for a resolution and recovery procedure. This procedure aims at keeping the healthy parts of the credit institution in difficulty in going concern. Deposits will in those circumstances often be transferred to another (sometimes newly created) credit institution, rendering any payout by the DGS superfluous. In the context of such resolution and recovery procedure the additional means of the resolution fund can obviously also be used.

58.The exception – link with resolution. The exception of article 10(6) allowing for a reduced 0,5 % target level of ex ante funding in Member States with a highly concentrated and interconnected market, is all the more questionable in this respect.

Even though most credit institutions of such Member State are of considerable size, the target level of funding is lower than required for other Member States. Member States which opt to authorize the reduced target level – with approval of the Commission – in fact signal that they will never let a major credit institution fail (and thus provide an “implicit deposit guarantee”). They therefore magnify the moral hazard problem linked to the “too big to fail problem”.

The idea is clearly that a DGS in these MS will never serve its primary purpose: payout of depositors in case of failure of a credit institution. The DGS will indeed not even be sufficiently funded to fulfill this task. The DGS can in those Member States only function as an extension of the resolution fund, pointing to the close connection between DGSs and bank resolution (see below nr 86). One might go so far as to question the added value of having a separate deposit guarantee system in those circumstances (see also below nr 108).

It should be noted that the Bank Resolution and Recovery Directive does not provide for a higher ex ante funding level of the resolution fund in those Member States.[135] This means that in these Member States the sum of funds available for resolution and recovery is smaller than in other Member States.

59.The exception – level playing field. Another ardent issue in this regard relates to the consequences of this exception for the realisation of a level playing field in the European Union.

In Member States which enjoy the exception, the target level of funding is lower than in other Member States. This means that credit institutions established in these Member States will pay fewer contributions than their competitors established in other Member States. Even if the economic effect would be considered marginal, the exception on principle undermines one of the goals of the new Directive, the creation of a level playing field, as credit with a similar profile will pay different contributions in different Member States.[136]

60.The exception – pan-European DGS. If the Directive is to be considered as a step in an evolution which may end in a pan-European DGS, as many do,[137] the reduced ex ante funding level is equally problematic. One of the main obstacles to an immediate unification of all European DGSs into one pan-European fund, has precisely been the considerable difference in levels of funding of European DGSs. The new Directive intends to harmonise DGSs in this respect. The exception will however still leave certain DGSs with a substantially lower level of ex ante funding, possibly jeopardising further integration of national DGSs in the future.

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[135] See art. 102 of Directive 2014/59/EU.

[136] See amongst other recitals 3, 6, 7 and 13.

[137] Amongst others M Gerhardt and K Lannoo, ‘Options for reforming deposit protection schemes in the EU’ (March 2011) ECRI Policy Brief, No 4, at 11-12; Kleftouri (n 19) at 124-125.

The exception clearly takes a Member State instead of an internal market view to banking stability. Even if on Member State level "*credit institutions operate in a highly concentrated market where most credit institutions are of such a size and degree of interconnection that they would be unlikely to be wound up under normal insolvency proceedings without endangering financial stability*", this may be different if considered from an EU perspective.[138] If the aim of the Banking Union is to make a further or even the last step towards an internal financial market, considerations with respect to the concentration and degree of interconnection of the financial market should not be made at Member State level. The Directive therefore does not appear to contribute to more Banking Union in this respect.

61.Minimum harmonisation of the target level. According to the EBA guidelines, the target level of ex ante funding only aims at minimum harmonization (nr 52). Member States may set a higher target level or provide that a DGS may request further ex ante contributions, even after the target level has been reached. From a depositor protection point of view this position seems plausible. Different levels of funding between different DGSs will however again distort the level playing field between credit institutions from different Member States. Moreover, to the extent the Directive is to be seen as a first step towards a pan-European DGS, such differences will make a future integration of national funds more difficult.

62.Payment Commitments. Payment commitments are a new means of funding in EU legislation as well as in most Member States. The approach was introduced to prevent too much liquidity from being frozen in DGSs while ensuring that sufficient financial means are available to the fund if necessary.[139]

From a prudential standpoint a payment commitment should nevertheless be treated equivalent to a cash payment. If the accounting treatment of a cash payment differs from that of a payment commitment, the supervisory authority should assess the risks to which the capital and liquidity positions of the credit institution would be exposed should the DGS call upon the credit institution to pay the commitment.[140]

It remains to be seen how DGSs will deal with payment commitments. As it is not an automatic right for credit institutions to contribute up to 30 % by means of payment commitment, it may well be that different DGSs develop different policies in this respect, which may distort the level playing field between credit institutions that are member of a different DGS.

c. Ex post funding

i. Rule

63. Additional ex post funding. The Directive requires additional ex post funding in circumstances where the DGS should proceed to payout but its available financial means are insufficient to repay all covered deposits of the failing credit institution. In such cases the members of the DGS should pay extraordinary contributions not exceeding 0,5 % of their covered deposits per calendar year. In exceptional circumstances and with the consent of the competent authority, even higher contributions can be required (art. 10 (8)).

[138] Véron (n 125) at 12.
[139] See EBF, 'Comments on current Trilogue Discussions on the DGSs Directive' (15 November 2013) at 2.
[140] EBA, Guidelines on payment commitments under Directive 2014/49/EU on Deposit Guarantee Schemes, EBA/GL/2015/09 at 18.

64.Deferral. The competent authority may defer, in whole or in part, a credit institution's payment of extraordinary ex post contributions, if the contributions would jeopardise the liquidity or solvency of the credit institution. The contributions should then be paid when such payment no longer jeopardises the liquidity or solvency of the credit institution (art. 10 (8), second para).

ii. Evaluation

65.Advantages of ex post funding. Ex post funding can be seen as efficient in that the funds are only gathered when actually needed; funds are not immobilized beforehand.[141] Moreover as credit institutions know they will have to contribute in case of failure of another credit institution, they would have an incentive to monitor each other's activities (market discipline).[142]

66.Disadvantages of (exclusive) ex post funding. Exclusive ex post funding however has important downsides, which clarify why this option was not withheld in the Directive. It implies that the failed bank will not have contributed to the fund, which creates another moral hazard problem: a credit institution will rather want to be helped by other banks than having to contribute to save another bank. This could encourage more risky behavior, except for adequate prudential supervision. From a European Union perspective credit institutions which are member of a DGS that operates under ex post funding have more resources to generate returns compared to credit institutions which have to use part of their funds to pay ex ante contributions to their DGS, distorting competition in the internal market.[143]

But even non-exclusive ex post funding, as a complement to ex ante funding, has some disadvantages. A DGS will often need to proceed to payout in times of economic crisis. If ex post funding is required in that situation, credit institutions have to contribute when economic circumstances are already deteriorating and their financial means decreasing. Ex post funding mechanisms are therefore intrinsically procyclical. It encourages risk-taking in good times (no or fewer contributions to be made), but drains liquidity from banks in times of stress.[144] The Directive recognises this problem, by allowing deferral of contribution in case such contribution would jeopardise the liquidity or solvency of the credit institution.[145] In times of crisis, when many credit institutions may call for deferral of ex post contributions, this may seriously diminish this source of funding.

Finally ex post funding may delay timely payout or require borrowing until sufficient contributions have been gathered.[146]

67.Balance. In view of the disadvantages of (exclusive) ex post funding, it is not surprising that the new Directive has opted for a substantial level of ex ante funding. Nevertheless the harmonised minimum target level of ex ante funding has been set at a level which can only cope with the failure of a small to medium sized credit institution (see nr 57). In case of failure of a larger credit institution this level of ex ante funding will not suffice to ensure payout of all covered deposits, explaining the subsidiary ex post funding obligations of credit institutions. In

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[141] Schich (n 18) at 71 refers to the flip side: opportunity costs of ex ante funding.
[142] Bernet and Walter (n 8) at 37.
[143] Impact Assessment (n 8) at 20.
[144] Impact Assessment (n 8) at 20; Bernet and Walter (n 8) at 37; Schich (n 18) at 71.
[145] Such deferral should however not be publicly communicated so as to avoid that the deferral would signal to the market that a credit institution is unable to fulfill its contribution duties.
[146] Bernet and Walter (n 8) at 37.

this manner the Directive has sought to strike a justifiable balance between a substantial level of ex ante funding, to be completed with other means of funding in case of need.

d. Adequate alternative funding arrangements

i. Rule

68.Ratio. Even the sum of ex ante and ex post funding will not in all circumstances (e.g. failure of a large credit institution) suffice to ensure payout of all covered deposits. The Directive therefore requires Member States to ensure that Deposit Guarantee Systems have in place "*adequate alternative funding arrangements to enable them to obtain short-term funding to meet claims*" (art. 10 (9), also Recitals 34).

69.Government credit line. Those alternative funding arrangements are typically government credit lines which can be easily called upon in case of need.[147]

ii. Evaluation

70. State guarantee? According to the explanatory memorandum to the 2010 proposal alternative funding arrangements are one of the lines of defense against taxpayers' involvement in rescuing a credit institution.[148] In our view a state guarantee can therefore only take the form of a credit line from the government, which should afterwards be paid back by the DGS with new contributions by its members-credit institutions. Rules on state aid should moreover be complied with.[149]

71. No obligation. Most Member States already have a government credit line in place to ensure compensation of depositors if the DGS would be unable to cope with its obligations.[150] In the Icesave case the EFTA Court nevertheless decided that there was no obligation on the State and its authorities to ensure compensation.[151] In spite of the obligation for Member States to ensure that DGSs have adequate alternative funding arrangements, recital 45 of Directive 2014/49/EU reiterates that the Directive should not result in the Member States or their relevant authorities being made liable in respect of depositors, as long as they have ensured that Deposit Guarantee Systems have been introduced and officially recognized in accordance with the requirements of the Directive.

72.Other alternative funding arrangements? The conclusion should be that other alternative funding arrangements should be possible. One possibility is to require deposit guarantee funds to take out re-insurance against risks that would be too large to be covered by them. A recent publication went one step further in advocating the creation of a European Reinsurance Fund (EReIF) which would provide such reinsurance, financed by premia paid by the national DGSs.[152]

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[147] A 2008 JRC Report indicated that at the time only 5 Member States did not allow their DGSs to call for a government loan in case of a shortfall, while in about two thirds of EU Member States there was no limit to the amount of resources which could be borrowed. See European Commission, Joint Research Centre, 'Investigating the efficiency of EU Deposit Guarantee Schemes' (2008) at 3.

[148] Explanatory memorandum to the 2010 Proposal (n 34) at 8.

[149] Impact Assessment (n 8) at 8.

[150] See footnote 147.

[151] Case E-16/11, EFTA Surveillance Authority v. Iceland (Icesave) (28 January 2013) Judgment of the EFTA Court para 144. See also the case note of M Hanten and M Plaschke, 'EU law impact on deposit protection in the financial crisis: Icesave' (2014) 51 CMLR at 295-310.

[152] R Goyal and others, 'A Banking Union for the Euro Area" (February 2013) 13/01 IMF Staff Discussion Note at 23, nr 42; D Gros, 'Principles of a Two-Tier European Deposit (Re-)Insurance System' (17 April 2013) CEPS Policy Brief N° 287.

e. Borrowing between DGSs

i. Rule

73.Voluntary borrowing. Member States may allow their DGSs to lend to other DGSs within the Union on a voluntary basis, when a number of conditions are fulfilled (art. 12 (1)).

ii. Evaluation

74.Solidarity between DGSs? The original 2010 proposal provided for a mandatory mutual borrowing arrangement, that would have allowed a DGS to borrow from all other DGSs in the EU, which would have had to lend a maximum of 0,5 % of their eligible deposits on short notice, proportionate to the amount of eligible deposits in each country.[153] This mutual borrowing arrangement was considered a first step towards a pan-European DGS.[154]

The final version of Directive 2014/49/EU however can at best be considered a very prudent step towards solidarity between the different DGSs. It is left to the Member States to allow voluntary lending and then it is up the DGS to decide whether or not to lend.

A national DGS will need financial support typically if the Member State experiences a systemic crisis. These will be exactly the conditions under which other DGS systems will not want to lend.[155] Therefore the borrowing arrangement seems unlikely to be used very often.

f. Calculation of contributions

i. Rule

75.Contributions by credit institutions. All four means of funding described above are directly or indirectly based on contributions of credit institutions. Indeed, borrowing arrangements and government credit facilities will, too, need to be repaid with new contributions of credit institutions. This raises the question of how those contributions should be calculated.

76.Risk-based contributions. The Directive obliges DGSs to levy risk-based contributions: contributions should not only be based on the *amount* of covered deposits of a credit institution, but also on the degree of *risk* incurred by each respective member of the DGS (art. 13 (1) and recital 36). This principle applies to both ex ante and ex post contributions.[156]

The 2010 proposal gave important directions in this regard. The final Directive leaves it to the Member States to use their own risk-based methods for determining and calculating the risk-based contributions. The Directive only indicates that the calculation of contributions should be proportional to the risk of the members and should take due account of the risk profiles of the various business models. Each method should be approved by the competent authority in

[153] Explanatory memorandum to the 2010 Proposal (n 34) at 7 and article 10 of the 2010 Proposal.
[154] European Commission, 'Report to the European Parliament and tot the Council – Review of Directive 94/19/EC on DGSs' (12 July 2010) COM(2010)369 final at 4-5; L Quaglia, *The European Union and Global Financial Regulation* (2014 Oxford University Press) at 172.
[155] Gros (n 152) 5.
[156] EBA, Guidelines on methods for calculating contributions to deposit guarantee schemes, EBA/GL/2015/10 at 8 paras 5 and 9, para 13.

cooperation with the designated authority[157]. EBA needs to be informed of the approved methods (art. 13 (2)).

EBA was given the task to issue guidelines to specify methods for calculating the contributions to DGSs, including calculation formula, specific indicators, risk classes for members, and thresholds for risk weights assigned to specific risk classes (art. 13 (3)). After having conducted a test exercise on three different systems for calculating risk-based contributions, EBA organised a consultation and finally issued guidelines on this matter on 28 May 2015.[158]

77.Procyclicality. In setting the level of annual ex ante-contributions due account should be taken of the phase of the business cycle and the impact procyclical contributions may have (art. 10 (2) fourth paragraph). The EBA guidelines on methods for calculating contributions to the DGS give further guidance in this respect. Although the total amount of contributions to the DGS in a given year should depend on the riskiness of its member institutions and the amount of their covered deposits, an adjustment coefficient should factor in the business cycle in order to avoid excessive contributions during economic downturns, and to allow faster build-up of the DGS in economic upturns. The supervisor should assess this component of the calculation method taking into account relevant macro-prudential information.[159]

ii. Evaluation

78.Historic background. Directive 94/19/EC did not contain any provisions on contributions or the way these should be designed.[160] At the time, contributions to DGSs were usually calculated as a percentage of eligible deposits.[161]

79.Moral hazard. This method however creates a moral hazard problem: risk takers, which face a higher probability of bankruptcy and thus a higher probability that the DGS would have to pay out their depositors, do not face higher contributions than more prudent credit institutions:

[157] Defined as a body which administers a DGS pursuant to this Directive, or, where the operation of the DGS is administered by a private entity, a public authority designated by the Member State concerned for supervising that scheme pursuant to this Directive (art. 2 (1) (18)).

[158] EBA, Guidelines on methods for calculating contributions to deposit guarantee schemes, EBA/GL/2015/10. The guidelines specify five categories of risk indicators, provide guidance for assigning weights to the risk categories and indicators, but also leave room for national supervisors to introduce additional risk indicators if they consider the core indicators do not sufficiently take into account the characteristics of the member institutions. Competent authorities should ensure that the Guidelines are respected when approving the own risk-based methods.

[159] EBA, Guidelines on methods for calculating contributions to deposit guarantee schemes, EBA/GL/2015/10 at 14, para 38: "*The cyclical adjustment should take into account the risk analysis undertaken by the relevant designated macroprudential authorities and reflect current economic conditions as well as medium-term perspectives, as persistent economic difficulties may not justify low contributions indefinitely. Competent authorities that have approved an own risk-based method pursuant to Article 13(2) of Directive 2014/49/EC may require an amendment of the calculation method to properly reflect developments in the business cycle that have occurred since the initial approval of the method. The cyclical adjustment may also take into account expected evolutions in the covered deposits base.*"

[160] The 92 Proposal however shows that the Commission already at that time was aware of the importance of risk based contributions. See 92 Proposal (n 24) at 5: "*In addition, managers of credit institutions have been encouraged to hold risky portfolios, without market discipline requiring them to pay their guarantee scheme high premiums because of the increased risk of bankruptcy which such investments represented for the institution. In this ways institutions benefited from taking risk while losses were borne by the guarantee scheme*."

[161] C Goodhart, 'How should we regulate the financial sector' in A Turner and others, *The future of finance and the theory that underpins it*, (London School of Economics Press 2010) at 167.

they benefit from taking risk, while losses are born by the guarantee scheme.[162] Therefore many States had already introduced a more risk based contributory system.[163]

The obligatory risk based calculation of contributions in the Directive should therefore be welcomed from a stability perspective. From an internal market perspective full harmonization of the calculation of contributions would have been preferable. Allowing Member States to develop different calculation techniques however has an important advantage: slightly different systems will operate next to each other, so that a form of regulatory competition can take place. Member States – and in the end the Commission – can learn which system produces the best results.

VI. Conclusion : Towards a European DGS as a Third Pillar of the Banking Union?

a. Evaluation of the Directive in function of banking stability

80.Fairly balanced. Directive 2014/39/EU can be considered as one of the better prepared legislative acts in European financial law, with extensive reports, impact assessments and both legal and economic literature on almost every aspect of deposit guarantee. The key elements of the new European Directive have clearly been well-considered and are – taken as a whole – fairly balanced in terms of the burden imposed on credit institutions and the improvement of banking stability in the EU.

Nevertheless not all choices made seem to fit the goal of increasing banking stability.

81.Coverage level. The coverage level has been harmonised at EUR 100,000. The need to create a level playing field for all credit institutions in the European Union and to prevent regulatory competition between Member States, was the motivation for fixing a maximally harmonised coverage level.[164]

A harmonised *fixed* coverage level is however not necessary from a banking stability or depositor protection point of view, nor to achieve a level playing field or to avoid regulatory competition. The idea behind the coverage level of the Directive is that a vast majority of depositors should be fully covered (see nrs 23 and 24). This goal could however be achieved more accurately if the coverage level was set in every Member State at a level ensuring full coverage of a fixed percentage of depositors, e.g. 98 %. This would result in differences in the coverage levels in the different Member States, without giving rise to regulatory competition. As the vast majority of depositors would be fully covered, there would indeed be no incentive for those depositors to transfer money to Member States with a higher coverage level.

A valid reason for the Directive to introduce a maximally harmonised fixed coverage level, would nevertheless be to facilitate the introduction of pan-European DGS in a later phase (see nr 28).

[162] Schich (n 18) at 72; see also n 160.
[163] Schich (n 18) at 72. In Belgium the Constitutional Court declared the Belgian contribution system, based on the amount of covered deposits at the bank, discriminatory and thus unlawful (Constitutional Court (23 June 2011) nr 115/2011). One of the arguments was that for the calculation of contributions not only the potential amount of payout by the fund should be taken into account, but also the extent to which the credit institution risks to encounter financial difficulties that would necessitate a payout by the fund.
[164] Impact Assessment (n 8) at 31.

82.Payout period. The Directive has reduced the payout period to a bold 7 working days. From a banking stability perspective a very short payout period is indeed key. This very short payout period however raises several concerns.

First, many depositors may not enjoy payout within this timeframe to the extent that one of the exceptions of article 8(5) apply, allowing an undetermined prolongation of the payout period (see nr 44).

Second, the banking sector faces a heavy financial burden since it has to build computerised systems enabling credit institutions to promptly deliver the necessary information in order to allow for a timely payout by the DGS (see nr 40-42).

The question moreover arises how important the payout function of the DGS will still be in view of the new intervention mechanisms provided by the Bank Recovery and Resolution Directive, which will be the first line of defense when a credit institution faces financial turmoil (see nr 86).

83.Funding. From a stability perspective harmonisation of the funding requirements for European DGSs represents a big step forward compared to the pre-existing situation where several European schemes were unfunded or heavily underfunded. Nevertheless the ex ante funding level set under the new Directive is still insufficient to ensure payout of depositors of a relatively large credit institution. Additional ex post funding and alternative financing arrangements should solve that problem.

In order to meet the procyclicality argument, the Directive however allows deferral of ex post contributions in case such contribution would jeopardise the liquidity or solvency of a credit institution. In times of crisis, when many credit institutions may call for deferral of ex post contributions, this may seriously impair this source of funding (see nr 66).

Alternative financing arrangements – typically a government credit line – should then be triggered as a next line of defence. Although not a requirement under the Directive (cf. recital 45), a government credit line would guarantee the payment obligation of the DGS towards depositors. It could be argued that a guarantee towards a DGS represents a lower risk to a Member State than guarantees or loans to individual banks such as those made during the recent crisis.

From a stability perspective the reduced ex ante target level of at least 0,5 % of covered deposits for highly concentrated markets where most credit institutions are of a considerable size and degree of interconnection (see nr 54), is contra-intuitive. Member States with just a few large credit institutions would in principle need better-funded DGSs in order to be able to cope with a failure. This exception can only be understood if the Directive is considered in the wider context of the Banking Union. In these highly concentrated markets with only credit institutions of considerable size, no credit institution will be allowed to fail under the ordinary insolvency procedure. In such a situation the resolution procedure will always be started. DGSs can in those MS therefore only function as an extension of the resolution fund (see nr 86).

84.The Directive and the Banking Union. The evaluation of the Directive on three elements essential for achieving depositor confidence and thereby banking stability, has made clear that not all choices can be fully explained by those goals. Some provisions seem to look ahead and rather have as a purpose to facilitate a future integration of Member States' DGSs into a pan-European fund. Other provisions clearly demonstrate that the DGSs are just one element of a wider system to ensure banking stability.

In the following sections the Directive will therefore first be put in the wider context of the Banking Union (b), in order to subsequently evaluate the added value of a pan-European DGS as a fully-fledged third pillar of the banking union (c), and to finally conclude with the question whether integration should even go beyond the idea of a pan-European DGS and encompass resolution funds as well (d).

b. Deposit guarantee as a third pillar of the Banking Union

85.Historic background. The idea of a "pan-European DGS" is older than the first ideas of a Banking Union in Europe. It was first launched, but rejected, at the EU level in the so-called "De Larosière report".[165] It was subsequently picked up by the Commission and in literature.

In 2010 the European Commission examined three possibilities to improve cross-border cooperation among DGSs and overcome fragmentation of the system.[166] It considered the creation of a 28th regime, but dismissed this as ineffective, since it would add complexity without resolving the inconsistencies stemming from the existence of almost 40 schemes in the EU. A second option explored was the creation of a network of existing schemes ("a European system of DGSs"). The Commission saw this as a structure "*relatively easy to set up today …, which would strengthen depositor confidence if there was a mutual borrowing facility between schemes, making the risk of government intervention less likely*". Such network could be a first step towards the establishment of a single pan-European scheme in the future. This last option, a single pan-European DGS, was considered the most cost-efficient, since it would save administrative costs of about EUR 40 million per year. The European Commission considered the last option therefore as an economically effective solution to overcome the fragmentation problem, but as there were still some legal issues to be further investigated, the idea was seen as a longer-term project (at the time subject to further review by 2014).[167]

The idea of a pan-European DGS gained momentum when the concept of a Banking Union was developed. The Banking Union has been claimed to rely on three pillars: a single supervisory mechanism, an integrated crisis management framework and a common system for deposit guarantee.[168] In the words of Benoît Coeuré, member of the Executive Board of the ECB: "*The SSM would bring all supervisory decisions about euro area banks under one roof, at the ECB, allowing supervisors to take into account externalities and general exposures to systemic risk. The common resolution structure, with a unified resolution regime and single resolution fund, would manage efficiently the wind-down even of large cross-border banks. Shared deposit insurance would reassure depositors that their money is safe in any euro area bank, regardless of its country of operations or legal domicile*."[169]

86.Three pillars of the Banking Union from a DGS perspective. From the perspective of deposit guarantee the relationship between the three pillars can be described as follows.

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[165] High Level Group on Financial Supervision in the EU, *Report* (February 2009) ("De Larosièrereport") at 35 para 136 : "*The idea of a pooled EU fund, composed of the national deposit guarantee funds, has been discussed by the Group, but has not been supported. The setting-up and management of such a fund would raise numerous political and practical problems. Furthermore, one fails to see the added-value that such a fund would have in comparison to national funds operating under well-harmonised rules (notably for coverage levels and the triggering of the scheme)*."

[166] European Commission, 'Report to the European Parliament and tot the Council – Review of Directive 94/19/EC on DGSs' (12 July 2010) COM(2010)369 final at 4.

[167] *Ibid*. at 4-5.

[168] See footnote 6.

[169] Cœuré (n 3).

A strong first pillar of the Banking Union is a prerequisite for a well-functioning third pillar not producing adverse effects. The introduction of a DGS is associated with a moral hazard problem, inducing credit institutions to engage in overly risky behavior (see nr 16). An increased focus on prevention and supervision should contain that problem (see nr 20) and should make bank failures and the need for payout by the DGS ever less probable.

If a bank nevertheless faces difficulties which could endanger banking stability, early intervention and resolution should prevent a disruptive and destabilizing failure. The newly established resolution procedure thus intends to avoid another instance of moral hazard, the "too big to fail problem" for large credit institutions. Via the resolution and recovery procedure, any failing institution, irrespective of its size and interconnectedness, should be able to exit without destabilising the market, while respecting its obligations towards depositors up to EUR 100,000 per depositor.[170] When a resolution action ensures that depositors continue to have access to their deposits the deposit guarantee scheme to which the credit institution under resolution is affiliated, will be required to make a contribution not greater than the amount of losses that they would have had to bear if the institution had been wound up under normal insolvency proceedings.[171]

Interventions by the deposit guarantee systems should therefore drastically decrease. They will only take place (i) to ensure of depositors in case of failure of a small credit institution which does not present any systemic risk and for which a resolution procedure would not be deemed necessary; (ii) in the context of a resolution procedure by partially funding resolution costs.

87.Partial realisation of the Banking Union. Pan-European banking supervision and resolution were inconceivable just a few years ago. Meanwhile the competence of banking supervision for the Eurozone has been transferred to the ECB and the decision to create a Single European Resolution Mechanism and Fund for the Eurozone has been taken (see nr 1). A pan-European deposit guarantee system however still seems highly difficult to achieve.

Directive 2014/49/EC can at best be seen as a first modest step towards a shared deposit guarantee system. It maximally harmonises key elements of DGSs in Europe, which is indeed indispensable if those funds would someday need to be united. However, as the Directive contains many exceptions to maximum harmonization of national DGSs, creating a single DGS would still require considerable changes to certain national DGSs even if these were in perfect compliance with the Directive. Furthermore the link between national DGSs is strikingly weak. The original proposal of the Directive aimed at introducing an obligatory mutual borrowing facility, which would in fact have created a network of DGSs instead of numerous isolated DGSs. In the final Directive the borrowing facility has been watered down to a Member State option functioning on a voluntary basis. The legal significance of this voluntary borrowing facility seems therefore mainly symbolic (see nr 743-74).

The only reference in the Directive to a pan-European DGS can be found in article 19 (5), which requires the Commission to submit, by 3 July 2019, "*a report, and, if appropriate, a legislative proposal to the European Parliament and the Council setting out how DGSs operating in the Union may cooperate through a European scheme to prevent risks arising from cross-border activities and protect deposits from such risks*".[172]

[170] Recital 45 of Bank Resolution and Recovery Directive 2014/59/EU.
[171] Recital 110 and art. 109 Bank Resolution and Recovery Directive 2014/59/EU.
[172] See also recital 4 of the Directive.

The contrast with the swift realisation of the other two pillars of the Banking Union could hardly have been any bigger. This begs the question why a common DGS was so much harder to achieve. Political resistance, from Germany in particular, is often mentioned as a key factor. Fear that the DGSs would turn the EU into a "transfer union" and the consequences for the current German deposit insurance system of savings and cooperative banks, were at the basis of this opposition.[173]

It is all the more important to examine whether further integration of Member State DGSs into a pan-European fund would fundamentally improve DGS efficiency, market integration and banking stability in the EU.

c. Does Europe need a third pillar for its Banking Union?

88.Network of national DGSs compared to pan-European DGS. In this section the advantages of a pan-European fund over (a network of) national DGSs will be examined in terms of efficiency, market integration and market stability.

i. Efficiency

89.Cost efficiency. The Commission has calculated that a pan-European Scheme would be economically efficient, representing a yearly decrease of administrative costs of about EUR 40 million per year (see nr 85).

90.Capacity. Moreover the capacity of a pan-European fund would be a multiple of national DGSs' capacity. After the target ex ante funding level will have been reached, ex ante funding of national DGSs is estimated to be able to cope with payout for small and, at best, medium sized banks. A pan-European fund would however be able to deal with payout for even the largest European banks.[174]

A network of national DGSs could reach the same capacity if an obligatory mutual borrowing arrangement would be in place. Under Directive 2014/49/EU this borrowing arrangement is only optional and voluntary – symptomatic for the limited political will to achieve an integrated DGS-network as part of an integrated financial market. Nevertheless, even a perfectly working and unlimited mutual borrowing arrangement would still be likely to be less efficient than a pan-European DGS.[175]

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[173] D Schoenmaker and D Gros, 'European Deposit Insurance and Resolution in Banking Union' (May 2013) Vol 52 Issue 3 Journal of Common Market studies, at 532; H Zimmerman, 'The uneasy promise of deposit insurance: Financial globalization and the protection of savers' (August 2013) Vol 17 No 3 Competition and Change at 273 and 275.

[174] Schoenmaker and Gros (n 173) at 541-542.

[175] Some authors have come up with another alternative, a two-tier European deposit (re-)insurance scheme, which would collect premia from all national DGSs and would pay out in case losses at the national level would exceed a certain treshhold. See J Pisani-Ferry, A Sapir N Véron and G Wolff, 'What kind of European Banking Union?' (June 2012) issue 2012/12 Bruegel Policy contribution at 13; Goyal and others (n 152) at 23, nr 42; Gros (n 152) at 4-5.
This proposal would indeed solve the problem that ex ante funding of national DGSs is insufficient in case of failure of large credit institutions or in case of (national) systemic crises. It would moreover prevent that additional ex post funding is only borne by national credit institutions, even when the failing credit institution also has a large pool of depositors of other Member States (see nr 96). The other arguments made in favour of a pan-European fund are however unresolved by this proposition (see nrs 91and following).

91.Experience. Efficiency gains would moreover result from increased experience of a pan-European scheme compared to national DGSs which are relatively rarely confronted with payout procedures.

92.Cross-border credit institutions. A pan-European fund would moreover be able to deal more efficiently with the failure of credit institutions with many cross-border depositors.[176] Not only would cross-border payouts be more efficiently managed than under the current system. The creation of a pan-European DGS would also solve the problem that the home state has to reimburse foreign depositors.[177]

93.Cooperation between different pillars at different levels. Finally the remarkable asymmetry between a Single Supervisory Mechanism and a Single Resolution Mechanism for the Eurozone on the one hand and (a network of) nationally operated DGSs on the other is in itself an argument in favour of a pan-European DGS, at least for the Eurozone.

Although prudential supervision in the Eurozone is performed at Eurozone level, the ruling on unavailability of deposits will still be made at national level. Although de facto a close cooperation between the ECB and the national authorities is necessary in any event, this asymmetry is conceptually unsound. Conflicts may indeed arise between the European supervisor and the national DGS, where for example the national DGS could blame the ECB for insufficient supervision, leading to a situation necessitating pay-out.[178]

In the context of a resolution procedure the Single Resolution Fund, funded by all credit institutions of the Eurozone, will moreover often need to cooperate with a national DGS, funded by the credit institutions of the home member state of the ailing credit institution only. Again this asymmetry is undesirable from an efficiency perspective.[179]

The advantages of having all pillars of the Banking Union organised at the same level[180] is another argument to favour a pan-European DGS.[181]

ii. Level playing field

94.Unlevel playing field created by national DGSs. Although the Directive claims to further the internal market, it also introduces several provisions which create an unlevel playing field and unfair competition.

95.Fixed coverage level. First, as indicated above, the fact that the Directive provides for a harmonised coverage level of EUR 100,000 means that in Member States with a lower average income level a higher percentage of depositors will be fully covered. Credit institutions of these Member States will therefore face relatively higher contributions, as contributions are

[176] Article 14 (2) of the Directive provides that depositors at branches set up by credit institutions in another Member State shall be repaid by a DGS in the host Member State on behalf of the DGS in the home Member State. The DGS of the home Member State shall provide the necessary funding prior to payout and shall compensate the DGS of the host Member State for the costs incurred.

[177] Gerhard and Lannoo (n 137) at 11.

[178] Schoenmaker and Gros (n 173) at 535-536.

[179] The following inefficiencies have been described: less efficient risk pooling, which would not effectively decouple sovereigns and banks; complexities in cost allocation and implementation in the case of cross-border failures, requiring close coordination between national DGSs and the single resolution authority; and duplication of costs and administrative resources, as both funds would be assessed on the same banks. See Goyal and others (n 152) at 19-20.

[180] Ibid.; J Pisani Ferry and G Wolff, 'The fiscal implications of a banking union' (September 2012) Bruegel Policy Brief at 5.

[181] Schoenmaker and Gros (n 173) at 535-536.

calculated on the basis of *covered* deposits. A fixed coverage level may thus create an unlevel playing field (see nrs 28 and following).

96.Ex post funding. Second, in case a DGS needs to proceed to payout and ex ante funding is insufficient, ex post funding will be required only from the credit institutions of the Member State of establishment of the failing credit institution, even if the failing credit institution has a substantial number of depositors in other Member States. Again this leads to unfair competition. In a true internal market, ex post funding should be borne proportionally by all competitors in the market. This can however only be realized in the context of a pan-European fund.[182]

97.Lower ex ante funding for highly concentrated markets. Similarly the reduced target level of ex ante funding for Member States with a highly concentrated and interconnected market, means that credit institutions in these Member States have to contribute less to the fund, giving them an advantage over their competitors in other Member States, which is not compensated for by adapting the ex ante target level of funding of the resolution fund in that Member State, as one might have expected (see nr 59).

98.Incomplete harmonisation. Numerous elements of the Directive have not been harmonised or only aim at minimum harmonization. The fact that the target level of ex ante funding of 0,8% of covered deposits only aims at minimum harmonization, means for example that the DGSs of the Member States may have different levels of funding. Incomplete harmonization also follows from other elements which are for the Member States to determine, such as the higher coverage level for temporary high balances and the risk based contributions by credit institutions (although for the latter guidance is provided by the EBA). These differences will further distort the level playing field. Moreover, to the extent the Directive is considered as a first step towards a pan-European DGS, such differences will make a future integration of national funds more difficult.

99.National DGS closer to the market it serves? An argument in favour of maintaining national DGSs would be that these are closer to the market they serve. The un- or incompletely harmonised elements of the Directive would then allow national DGS to adapt certain standards to the needs of the local market. One of the downsides mentioned with respect to a pan-European DGS is exactly that it would be very difficult to develop objective numerical criteria for risk-based contributions, which are valid in all member countries, as the business models of small banks vary from country to country and even similar financial instruments may represent different risks in different Member States due to differences in payment habits or in the national legal system.[183]

The European legislative framework however aims at deepening integration of the European financial markets. Considerable steps have recently been taken in the context of the Banking Union. Keeping a national focus with respect to DGS therefore seems inappropriate and indeed inefficient. The example of risk-based contributions is telling in this respect, as an ever more refined risk-assessment for the Eurozone will be developed in the context of the stress-tests for Eurozone credit institutions.

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[182] See however also the alternative described in footnote 175.

[183] Schoenmaker and Gros (n 173) at 540.

iii. Stability

100. Stability. Less straightforward is whether a pan-European fund would also bring more financial stability than national DGSs. Arguably this is the case.

101. More capacity. As mentioned above (nr 90) a pan-European fund has much more funds at its disposal than any single national DGS and would indeed be able to cope with the failure of even a large credit institution on the basis of available ex ante funding. Therefore a pan-European fund should inspire more confidence with depositors and add to banking stability.

102. Bigger loss absorbing capacity. Even if a pan-European fund would not be able to cope with the failure of one or several credit institutions, ex post funding would be a burden shared by all members - credit institutions of the Eurozone. Ex post contributions would thus be spread over more credit institutions, so that the impact on each of them would be lesser and the procyclical effect of ex post funding would decrease. This would again be beneficial for banking stability in the Eurozone.

103. Cross-border failure. A pan-European fund may further inspire more confidence in the host state where a credit institution provides cross-border services or establishes a branch, as depositors would know that one and the same DGS guaranteed their deposits irrespective of the Member State of establishment of the credit institution.

104. Independence of national government. When the entire banking sector of a certain Member State is stressed, the contingent losses are so high that the capacity of the state to provide a backstop[184] to the national DGS becomes questionable.[185] A pan-European DGS would on the contrary provide an external loss absorption mechanism, independent of the solvency of the state.[186]

105. Systemic risk of pan-European fund? A possible downside of a pan-European fund is that it may increase systemic risk. Mismanagement of the fund would indeed have a much bigger impact. A pan-European fund should therefore be subject to strict organisatory and management rules.

iv. Conclusion

106. Pan-European DGS improves efficiency, level playing field and stability. It could be argued that most of the level playing field arguments and the deficiencies of the borrowing arrangement in the Directive, are the result of the compromise struck for this Directive and do not as such mean that a pan-European DGS is to be preferred over a well-designed chain of national DGSs. Most efficiency and stability arguments can however not be resolved by adapting the Directive so as to create a true European network of national DGSs.

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[184] Cf. footnote 118.

[185] Schoenmaker and Gros (n 173) at 533.

[186] A pan-European DGS would nevertheless also need a backstop at EU-level. Different proposals have been made in this regard. According to Pisani-Ferry and others a quasi-treasury could be given a limited and contingent taxation capacity for the purpose of resolving banking crises, up to a certain proportion of GDP and to be triggered only in the event of depletion of the European deposit insurance. See J Pisani-Ferry and others (n 175) 14. It however seems more realistic to provide this backstop via existing channels, the European Stability Mechanism being the most appropriate body to perform this function. See D Schoenmaker and D Gros, 'A European Deposit Insurance and Resolution Fund' (May 2012) No. 364 CEPS Working Document, at 4.

The conclusion from this section is that in general and subject to certain conditions, a pan-European DGS would be more efficient and improve the level playing field and stability in the financial sector in comparison to a network of national DGSs.

d. Pan-European DGS in the Banking Union: already outdated?

107. Close link between resolution and deposit guarantee. Today, the ideal level at which to organize deposit insurance in Europe can no longer be considered in isolation from the resolution procedure.

As mentioned above (nr 86), in view of the newly introduced resolution procedure, DGS intervention will only take place (i) in case of failure of a small credit institution which does not present any systemic risk and for which a resolution procedure would not be deemed necessary; or (ii) in the context of a resolution procedure.

It is however questionable whether even a small credit institution facing financial difficulties will be left to be resolved under ordinary insolvency procedures. It would be more desirable to use the resolution procedure in these circumstances as well. The "primary" payout role of DGSs would then become mainly symbolic as the DGS would chiefly function as an additional financial resource – next to the resolution fund – in resolution procedures.

It is in any event surprising that Directive 2014/49/EU has not been drafted more explicitly in function of the resolution-supportive role of DGSs. The Directive breaths the idea of immediate payout of depositors upon unavailability of their deposits. In practice however DGSs may most often intervene in the context of a resolution procedure to ensure availability of deposits to depositors.

108. Towards an integrated resolution and deposit guarantee fund? This begs the question what the added value of maintaining two separate funds would still be. One of the most important objectives of resolution is the protection of covered deposits.[187] In a resolution procedure the relevant DGS will need to closely cooperate with the resolution authority. Some authors have therefore advocated the merger of national DGSs with the single resolution fund.[188] The Bank Resolution and Recovery Directive already allows Member States to use the same administrative structure for their resolution scheme as for purposes of their deposit guarantee scheme.[189]

One truly integrated resolution and deposit guarantee fund would indeed allow for swift decision-making. It would moreover avoid the co-existence of multiple agencies and funds,[190] which could lead to inter-agency conflicts.[191] Also for credit institutions this would be more

[187] Recital 45 and 71 of Bank Resolution and Recovery Directive 2014/59/EU; recital 81 of SRM Regulation (EU) N° 806/2014.

[188] Schoenmaker and Gros have made this proposal very concrete, developing a proposal for a "European deposit insurance and resolution authority (EDIRA)". See Schoenmaker and Gros (n 173) at 536 and following. Other authors also argue for the integration of the deposit and resolution funds. E.g. Goyal and others (n 152) at 19-20; F Allen and others, *Cross-border Banking in Europe: Implications for Financial Stability and Macroeconomic Policies* (Centre for Economic Policy Research 2011) at 107-108, recommendation 9.

Already the 1987 Recommendation made an explicit link with a proposal for Council Directive for the reorganization and winding up of credit institution which was at the time transmitted to the Council (Recital 3 of Recommendation 87/63/EEC). Since the crisis deposit guarantee schemes were more and more often explicitly linked to resolution funds. See e.g. the De Larosièrereport (n 165) at 35, para 136; IADI 2009 Principles (n 7), principle 6.

[189] Art 100(2) of Bank Resolution and Recovery Directive 2014/59/EU.

[190] Schoenmaker and Gros (n 173) at 529.

[191] Schoenmaker and Gros (n 173) at 537.

efficient, as they would have a single access point for communication and payment of contributions.

Such a combination would further reflect more accurately the current situation where it is generally agreed that "*a deposit insurance system is not intended to deal, by itself, with systemically significant bank failures or a "systemic crisis". In such circumstances all financial safety-net participants must work together effectively*."[192]

Such a combined fund could however only function if two important conditions are met: (i) a fixed percentage of the fund should be reserved for depositor protection; and (ii) the depositor protection function, with a deposit guarantee up to EUR 100,000, should be clearly signaled to depositors as one of the main function of the scheme.

The idea of a separate pan-European DGS can thus be considered outdated before it has ever been implemented. A combined resolution and deposit guarantee fund for the Eurozone seems the more adequate way forward. After the Single Resolution Fund will have been established, it may moreover become politically more feasible to integrate the national DGSs into the newly created Single Resolution Fund, much in the same way as the integration of the national resolution funds into the Single Resolution Fund .[193]

Rather than establishing a separate pan-European DGS, the creation of a single European resolution and deposit guarantee fund, therefore seems the most adequate way forward for the Banking Union.

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[192] See IADI 2009 Principles, n. 7 above, 1 and 7. Also Principle 6 – Relationships with other safety-net participants (p.3): "*A framework should be in place for the close coordination and information sharing, on a routine basis as well as in relation to particular banks, among the deposit insurer and other financial system safety-net participants. Such information should be accurate and timely (subject to confidentiality when required). Information-sharing and coordination arrangements should be formalised*."
See also principles 15 and 16 (at p 4).

[193] See recital 19-20 and articles 1, last paragraph and 77 of SRM Regulation (EU) N° 806/2014, which refer to an Agreement on the transfer of funds raised at the national level towards the Single Resolution Fund as well as on a progressive merger of the different funds raised at national level to be allocated to national compartments of the Single Resolution Fund.